[6.9.1] Acquisition by a company of its own shares (S176 – S186)

1. Introduction

1.1 Where a company acquires its own shares any amount paid in excess of the original issue price is treated as a distribution by virtue of **Section 130 TCA 1997**. This is an anti-avoidance provision enacted to counter arrangements whereby shareholders might take profits out of a company without attracting liability under Schedule F. **Chapter 9, Part 6 TCA 1997** permits capital gains tax treatment where, on or after 1 July 1991 a company acquires its own or its holding company's shares provided the conditions, set out in paragraph 2 below are met. This chapter complements Part 3, Chapter 6 of the Companies Act 2014 which sets out the circumstances in which a company may acquire its own shares. .

1.2 This instruction outlines the basic principles involved in share buy-backs and the procedures to be followed in Districts.

1.3 A buy-back (including the redemption, repayment and purchase) of its own shares by a quoted company (or of its own shares by a subsidiary of a quoted company) is not treated as a distribution. Consequently, the disposal of the shares by the shareholders concerned is within the charge to capital gains tax. [**Section 175 TCA 1997**].

1.4 For accounting periods ending on or after 31 January 2008 costs incurred by a company in buying back its own shares are not allowed as a deduction for tax purposes. However, subject to **section 81(2)(n)**, this provision does not apply to so much of any payment as consists of expenditure incurred by a company to the extent that it is incurred on shares acquired by the company and given by it as consideration for goods or services, or to an employee or director of the company. [**Section 176A TCA 1997**].

2. Conditions

2.1 A payment made by a company for the acquisition of its own shares will not be treated as a distribution if the following conditions are met:

(a) The company purchasing its own shares must be an unquoted trading company or the unquoted holding company of a trading group. [**Section 176 TCA 1997**].

(b) Payments made on or after 26 March, 1997 by a quoted company on the redemption, repayment or purchase of its own shares, will also fall within these provisions [**Section 175 TCA 1997**]

(c) The redemption, repayment or purchase must be made wholly or mainly for the benefit of the company's trade or the trade of a 51 per cent subsidiary (see par 10). [**Section 176 (1)(a)(i)(I) TCA 1997**].

(d) The redemption, repayment or purchase must not be part of any scheme the purpose of which is to enable the owner of the shares to participate in profits without receiving a dividend. **[Section 176(1)(a)(i)(II)].**

(e) The vendor must be resident and ordinarily resident in the State. **[Section 177(1) - (5) TCA 1997].**

(f) The vendor must have owned or be deemed to have owned the shares for at least 5 years (except in the case of inherited shares when 3 years is sufficient). **[Section 177(6) - (10) TCA 1997** and Example 2 in **Appendix 1].**

(g) There must have been a proportionate 25 per cent reduction in the vendor's interest in:

(i) the issued share capital, and,

(ii) the distributable profits

of the company and, where appropriate, of the group of which the company is a member**. [Sections 178 and 179 TCA 1997** and Examples 3 - 5 in **Appendix 1).**

(h) The vendor must not be connected (as defined by **section 186**) with the company immediately after the purchase. [**Section 180 TCA 1997** and Examples 6 and 8 of **Appendix 1**]

2.2 The conditions set out in (b) to (g) of paragraph 2.1 need not be met where the person to whom the payment is made applies the payment to discharge inheritance tax or a debt incurred for the purposes of discharging inheritance tax in respect of those shares. To qualify, the payment must be applied within 4 months of the valuation date in discharging the inheritance tax itself or within one week of the date the payment is made if it is applied in discharging a debt so incurred. It must also be shown that undue hardship would have been caused in otherwise discharging the inheritance tax (and, where appropriate, the debt incurred in discharging that tax). **[Section 176(1)(b) TCA 1997].**

2.3 There is a relaxation in the conditions (f) and (g) in paragraph 2.1 where shares are redeemed from a shareholder to enable an associate meet those requirements. (**Section 181 TCA 1997** and Example 7 in **Appendix 1).**

3. Purchase of shares of parent company

A payment by a company for shares of its parent will qualify for capital gains tax treatment if the payment would have so qualified had it been made by the parent itself for those shares. [**Section 176(2) TCA 1997].**

4. Definitions

4.1 In determining the proportionate reduction of the vendor's interest in the capital or distributable profits of a group, "group" means a company, which has one or more 51 per cent subsidiaries but is not itself a 51 per cent subsidiary of another company together with those subsidiaries; otherwise "group" means a company which has one or more 51 per cent subsidiaries together with those subsidiaries.

4.2 “Quoted company” includes a fellow group member of a quoted company **[Section 175(2) TCA 1997].**

4.3 A company is deemed to be a "51 per cent subsidiary" of another company if and so long as more than 50 per cent of its ordinary share capital is owned directly or indirectly by that other company. [**Section 9 TCA 1997**].

4.4 "Trade" does not include dealing in shares, securities, land, futures or traded options. [**Section 173 TCA 1997**].

4.5 "Associated persons" and "connected persons" are defined in **Sections 185 and 186 TCA 1997** respectively. [See **Appendix 2**]

5. Returns

5.1 A company which makes a payment which it treats as not being a distribution by virtue of **Section 176** must make a return on **Form AOS1** of this payment. The return is required at the same time as the Form CT1 for the accounting period in which the payment is made. Explanatory notes on the completion of Form AOS1 are available on Revenue's website www.revenue.ie or from any Revenue Office.

6. Procedure to be followed on receipt of Form AOS1

6.1. When a company submits a completed Form AOS1 for an accounting period the receipt should be recorded on computer record.

6.2 The Form AOS1 itself does not require processing.

6.3 **All Forms AOS1 received should be held centrally in each District.** The forms for each calendar year are to be kept together in serial number order. The calendar year to which a Form AOS1 relates is the calendar year in which the accounting period ends.

6.4 Forms AOS1 should therefore be detached from the Form CT1 at the time of processing and filed accordingly.

7. Capital Gains Tax Returns by Vendors

7.1 Generally, where a taxpayer claims capital gains tax treatment in respect of shares which have been bought back by the issuing company or one of its subsidiaries, this treatment may be accepted without question. However, the computer record should be checked to confirm that Form AOSI for the accounting period in which the buy-back took place, has been submitted by the company.

7.2 If it is confirmed that the Form AOS1 has been submitted this should be noted on the return. If there is no record of the Form AOS1 having been submitted the matter should be clarified with the company and the taxpayer as necessary.

8. The provisions of **Section 980 TCA 1997** apply where a company acquires its own shares. Thus where the shares acquired derive their value or the greater part of their value directly or indirectly from assets specified in **Section 980(2)** and the consideration exceeds €500,000 the company must deduct tax in accordance with **Section 980(4)** unless the vendor has obtained a clearance certificate under that section.

9. Examples

Examples showing the operation of the various provisions of **Chapter 9, Part 6 TCA 1997** are set out in **Appendix I** of this instruction.

10. As noted in **par 2.1(c**) the redemption, repayment or purchase of shares must be made wholly or mainly for the benefit of the company's trade or the trade of a 51 per cent subsidiary. In **Tax Briefing 25 (see Appendix II),** Revenue advised on how it applies this test. Where a company is unsure if a proposed buy-back satisfies this requirement Revenue will, if requested, give an advance opinion in relation to the "trade benefit test". Requests should be submitted in accordance with the “Guidelines on Revenue’s Service to Practitioners and Business Taxpayers” which is available on www.revenue.ie

APPENDIX I

EXAMPLE I

Shares with a nominal value of €10,000 are issued at par. They are redeemed six years later for €16,000 i.e. shares owned for at least 5 years. As the provisions of **Chapter 9, Part 6 TCA 1997** are satisfied the excess of the redemption proceeds over the amount subscribed i.e. €6,000 is not treated as a distribution.

The individual shareholder is liable to capital gains tax as follows -

Redemption proceeds	16,000
Cost of shares	10,000
Gain	6,000
Small gains exemption	1,270
Chargeable gain	4,730
Capital Gains Tax @ 33%	1,560.90

EXAMPLE 2

K acquired €1 ordinary shares of K Ltd as follows:-

2006	250	shares	cost	250
2010	500	"	"	750
2011	250	"	"	500
	1,000			1,500

The shares were all issued at par and are fully paid up.

K sells:-

350 shares to his son for €1,000 in 2012

600 shares to K Ltd for €1,800 in 2014 (i.e. K Ltd buys back 600 shares).

For the purposes of applying the five years ownership requirement to the 2014 disposal, shares sold in 2012 are matched with the latest acquisitions, i.e. 250 shares acquired in 2011 and 100 shares acquired in 2010. The shares sold to K Ltd in 2014 are matched with the earliest acquisitions, i.e.

2006	250	(held for more than five years)
2010	350	(held for less than five years)

Provided that the other conditions are satisfied, the sale of the shares acquired in 2006 qualifies for relief from the distribution charge, but the sale of the shares acquired in 2010 does not.

EXAMPLE 3

The issued share capital of D Ltd is 10,000 €1 ordinary shares, of which E holds 2,000, a fraction of 2/10 (20%).

If E sells 500 shares to D Ltd, D Ltd's issued share capital is reduced for tax purposes to 9,500 shares of which E holds 1,500, a fraction of 15/95 (15.79%).

Thus, although E has sold 25% of his original holding, his percentage holding has been reduced by only 21%, and the transaction will not escape the distribution provisions.

(To achieve a reduction of 25%, E would need to sell 589 shares.]

EXAMPLE 4

The issued share capital of X Ltd and the shares owned by Y are as follows:

		Issued	Owned by Y
€1	ordinary	20,000	3,000
€1	8% redeemable preference	12,000	5,000
		32,000	8,000

The accumulated undistributed profits of X Ltd are €3,600.

X Ltd purchases 1,000 of Y's ordinary shares for €2,000 and redeems 3,000 of his preference shares at par. The share capital of X Ltd is then:

		Issued	Owned by Y
€1	ordinary	19,000	2,000
€1	8% redeemable preference	9,000	2,000
		28,000	4,000

The nominal value of Y's shareholding as a percentage of the total shares in issue has been reduced from 25% (8,000/32,000) to 14.3% (4,000/28,000), so that the test prescribed in **Section 178(4)** is satisfied.

The profits available for distribution, and the amounts to which Y is entitled, are as follows:

Before the reduction	Profits		Ys Share
* Part 3 Companies Act 2014	3,600		540
* €100	100		15
* Preference dividend	960		400
* Excess of costs of purchase and redemption over profits available for distribution (€5,000 - €3,600)	1,400		210
	6,060	(19.2%)	1,165

After the reduction			
* Part 3 Companies Act 2014	Nil		Nil
* €100	100		11
* Preference dividend	720		160
	820	(20.9%)	171

The exhaustion of the distributable reserves results in an increase in Y's entitlement to share in profits, so that the consideration will not qualify for relief from the distribution charge. (**Section 178 TCA 1997**].

EXAMPLE 5

A is a shareholder in members of a group of trading companies as follows –

	X Ltd	Y Ltd	Z Ltd
Issued share capital	10,000	10,000	10,000
Nominal value of shares held by A	2,000	500	0

A sell his shares in Y Ltd to that company, but retains his shares in X Ltd. His interest before the sale is-

$$\frac{2,000}{10,000} + \frac{500}{10,000} + 0 = \frac{2,500}{10,000}$$

$$\frac{2.500}{10,000} \div 2 = \frac{12.5}{100}$$

After the sale, it is -

$$\frac{2,000}{10,000} + 0 + 0 = \frac{20}{100}$$

$$\frac{20}{100} \div 2 = \frac{10}{100}$$

$\frac{10}{100}$ is 80% of $\frac{12.5}{100}$ so A's interest in the group is not substantially reduced.

EXAMPLE 6

A owns the following shares in B Ltd

	Total issued	Held by A
€1 ordinary	10,000	4,000
€1 preference	5,000	1,000
	15,000	5,000 (33.33%)

On 1 December 2013, B Ltd purchases 2,000 ordinary shares and 1,000 preference shares from A leaving him with 2,000 ordinary shares out of a total issued share capital of 12,000 (16.57%). The reduction qualifies for relief from the distribution charge.

On 1 March 2014, B Ltd purchases the remaining preference shares and 2,000 ordinary shares from other shareholders. A then owns 2,000 ordinary shares out of a total issued share capital of 5,000 i.e. 33.33%. If he had held a 33.33% interest immediately after the purchase on 1 December 2013, relief from the distribution charge would not have been due, and will therefore be denied or withdrawn. (**Section 180 TCA 1997**].

EXAMPLE 7

H Ltd has an issued share capital of 10,000 ordinary shares of which J owns 500 and the trustees of a settlement (for which J has provided assets) own 2,500.

It is proposed that H Ltd should purchase all the 500 shares owned by J.

After the purchase, the trustees, who are associated with J will continue to hold shares in H Ltd, their shareholdings must therefore be included in calculating the reduction in J's shareholding interest, which will be:

Before the sale $\frac{500 + 2,500}{10,000}$ = 30%

After the sale $\frac{2,500}{9\ ,500}$ = 25.31%

Assuming that J satisfies all the other tests to obtain relief from the distribution charge, he still fails to show a reduction of 25% in his shareholding interest.

For J to satisfy the test of reduced shareholding, it would be necessary to reduce the holding of the trustees to 22.5% (75% of 30%).

To do this, the trustees sell 468 shares to H Ltd. The percentage holding is computed as follows:

$$\frac{2{,}500 - 468}{9{,}500 - 468} = \frac{2{,}032}{9{,}032} = 22.5\%$$

Although such a sale by the trustees does not itself satisfy the "substantial reduction of shareholding" tests it will still be relieved from the distribution charge, as will the sale by J. If the trustees sold 500 shares to H Ltd, the proceeds of the excess 32 shares would suffer a distribution charge. (**Section 181 TCA 1997)**.

EXAMPLE 8

A Ltd has 1,000 shares in issue of which X owns 400.

B Ltd has 100 €1 shares in issue all of which are owned by A Ltd.
B Ltd has borrowed €500 from X.

If A Ltd purchases 200 shares from X, X's shareholding in A Ltd is reduced from 40% (400/1,000) to 25% (200/800), which satisfies the substantial reduction in shareholding test set out in Section 178.

As he holds no shares in B Ltd he does not have to satisfy the group test set out in section 179.

However, he will not escape the distribution charge because he is still connected with B Ltd.; he owns 83.3.% (500/600) of the total of B Ltd's issued share and loan capital. (**Section 185 TCA 1997**].

APPENDIX II

Extract from Tax Briefing, Issue 25 (February 1997)

1. Introduction

Where a company acquires its own shares any amount paid in excess of the original issue price is treated as a distribution by virtue of **Section 130 TCA 1997** (formerly Section 84 Corporation Tax Act 1976). However, **Sections 173 to 186 TCA 1997** (formerly Sections 59 to 72 Finance Act 1991), permit capital gains tax treatment where a company buys its own or its holding company's shares providing certain conditions are met. One of these conditions is that the purchase is made "wholly or mainly for the purpose of benefiting a trade carried on by the company or by any of its 51 per cent subsidiaries" - **Section 176(1)(a)(i)(I) TCA 1997 (**formerly Section 61(l)(a)(i)(I) Finance Act 1991) refers. This article sets out how this **trade benefit test** is applied by Revenue and also how an advance opinion may be obtained in a particular case if required.

References in this article to purchase/buy-back of shares includes redemption, repayment or purchase of its own shares by a company, as appropriate.

The legislation deals with the buy-back of shares by unquoted companies or unquoted holding companies of trading groups. For share buy-backs on or after 26 March 1997 quoted companies, including fellow group members of a quoted company are also included.

2. Trade Benefit Test

This test requires that it be shown that the sole or main purpose of the buy-back is to benefit a trade carried on by the company or of one of its 51% subsidiaries. The test would not be met where, for example, the sole or main purpose of the buy-back is to benefit the shareholder or to benefit a business purpose of the company other than a trade e.g. an investment activity.

Revenue will normally regard a buy-back as benefiting the trade where for example:

- There is a disagreement between the shareholders over the management of the company and that disagreement is having or is expected to have an adverse effect on the company's trade and where the effect of the transaction is to remove the dissenting shareholder.

- There is a disagreement between the shareholders over the management of the company and that management is having or is expected to have an adverse effect.

- The purpose is to ensure that an unwilling shareholder who wishes to end his/her association with the company does not sell the shares to someone who might not be acceptable to the other shareholders.

Examples of this would include:

– An outside shareholder who has provided equity finance and wishes to withdraw that finance

– A controlling shareholder who is retiring as a director and wishes to make way for new management

– Personal representatives of a deceased shareholder where they wish to realise the value of the shares

– A legatee of a deceased shareholder, where she/he does not wish to hold shares in the company.

The above examples envisage the shareholder selling his/her entire shareholding in the company and making a complete break from the company. If the company is not buying **all** the shares owned by the vendor or if the vendor is selling all the shares but retaining some connection with the company (e.g. directorship) it would seem unlikely that the transaction would benefit the company's trade.

However, there may be situations where:

- For sentimental reasons a retiring director of a company wishes to retain a small shareholding in the company

- A controlling shareholder in a family company is selling his/her shares to allow control to pass to his/her children but remains on as a director for a specified period purely because his/her immediate departure from the company at that time would otherwise have a negative impact on the company's business.

In such circumstances it may still be possible for the company to show that the main purpose is to benefit its trade.

3. Advance Opinion

Where a company is unsure whether a proposed buy-back is for the benefit of the trade and where all the other legislative requirements have been met Revenue will, if requested, give an advance opinion on the question whether the proposed buy-back satisfies the "trade benefit test". Requests should be [submitted in accordance with the “Guidelines on Revenue’s Service to Practitioners and Business Taxpayers” which is available on www.revenue.ie]

Applications for an advance opinion should:

- Confirm that all the other requirements of the legislation have been met

- List the current shareholders in the purchasing company together with particulars of the shareholdings and their relationship with each other, if applicable. If it is a group situation a statement or diagram of the group structure would be helpful.

[6.9.1]

- State the reason for the share buy-back and the trading benefit expected to accrue to the company (or its 51% subsidiary) State the name(s) of the person(s) disposing of the shares, the number and type of shares involved in the buy-back and the date(s) the shares were acquired.

- State the amount to be paid for the shares, how this is to be financed and how the latter will impact on the financial position of the company.

- Include a copy of the most recent accounts of the company.