



Department  
for Business  
Innovation & Skills

COMPANIES ACT 2006

Restricting share capital  
reductions in takeovers

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# Restricting share capital reductions in takeovers

## Who is likely to be affected?

Companies that are parties to a future takeover to be implemented by means of a 'cancellation' scheme of arrangement, advisers to such companies, and their shareholders and creditors.

## General description of the measure

The measure will protect the stamp taxes base by preventing the use of share cancellations by target companies in takeovers conducted using schemes of arrangement. Companies effecting a takeover or merger would in future be required to use a 'transfer' scheme of arrangement or a contractual offer, on which stamp tax on shares<sup>1</sup> is payable.

## Policy objective

The Government's objective is to ensure that stamp tax on shares is payable regardless of the mechanism used to effect it.

## Background to the measure

This measure was announced in the Autumn Statement on 3 December 2014.<sup>2</sup> The Government consulted informally with relevant experts over the policy and the detail of the 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 in order to circumvent the legislation.

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<sup>1</sup> In this paper the term stamp tax on shares is used as shorthand to describe the two types of transaction tax or duty arising on share transactions: 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 consideration is over £1,000. In both cases a tax or duty of 0.5% of the consideration is usually payable. For more information see <https://www.gov.uk/tax-buy-shares>

<sup>2</sup> HM Treasury (2014), Autumn Statement 2014, <https://www.gov.uk/government/publications/autumn-statement-documents>

## Detailed proposal

### Operative date

This measure will affect takeovers in relation to which a 'firm offer' announcement (as required by the Takeover Code<sup>3</sup>) is made after the day the statutory instrument is made, which is expected to be in early 2015. For companies not subject to the Takeover Code, the regulations will not apply to any takeover where the terms of the takeover have been agreed between the parties before the regulations come into force.

### Current law

Schemes of arrangement are a court approved arrangement between a company and its shareholders and creditors governed by Part 26 of the Companies Act 2006.<sup>4</sup> 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 on the other hand is effected through 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. Implementation of a 'transfer' scheme requires payment of stamp tax on shares at 0.5% of the consideration paid for the shares, but no such liability flows from implementation of a 'cancellation' scheme, the taxation of the new issue of shares being prohibited by the EU Capital Duties Directive (2008/7/EC).<sup>5</sup>

### Proposed revisions

Secondary legislation will be introduced to amend section 641 of the Companies Act to prohibit a company from reducing its share capital as part of a scheme of arrangement where the purpose is to implement certain takeovers or mergers.

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<sup>3</sup> The Takeover Panel Takeover Code - <http://www.thetakeoverpanel.org.uk/wp-content/uploads/2008/11/code.pdf>

<sup>4</sup> Schemes of arrangement are court approved arrangements between a company and its shareholders and creditors governed by Part 26 of the Companies Act 2006. Further details about schemes of arrangement can be found at: <http://www.hmrc.gov.uk/manuals/stsmanual/STSM077070.htm>

<sup>5</sup> See

<http://eur-lex.europa.eu/LexUriServ/LexUriServ.do?uri=OJ:L:2008:046:0011:0022:EN:PDF>

## Summary of impacts

Impact	Description					
<b>Exchequer impact (£m)</b>	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20
	Negligible	+65	+65	+55	+50	+50
	The analysis of the exchequer impact of the proposed change was produced by HMRC, and has been certified by the Office for Budget Responsibility. Further details can be found in the Autumn Statement and the accompanying policy costing document. <sup>6</sup> This measure is expected to have an on-going positive impact for the exchequer – raising tens of millions of pounds annually.					
<b>Economic impact</b>	This measure is not expected to have any significant macroeconomic impact compared to not taking action.					
<b>Impact on individuals, households and families</b>	<p>This measure is not expected to have any impact on individuals, households or families compared to not taking action. Below the impact on families is assessed using the 5 questions of the DWP Family Test.<sup>7</sup></p> <ul style="list-style-type: none"> <li>• What kinds of impact might the policy have on family formation? - This measure is not expected to have any impact on family formation.</li> <li>• What kind of impact will the policy have on families going through key transitions? - This measure is not expected to have any impact on families going through key transitions.</li> <li>• What impacts will the policy have on all family members' ability to play a full role in family life? - This measure is not expected to have any impact on family members' ability to play a full role in family life.</li> <li>• How does the policy impact families before, during and after couple separation? - This measure is not expected to have any impact on families before, during and after couple separation.</li> <li>• How does the policy impact those families most at risk of deterioration of relationship quality and breakdown? - This measure is not expected to have any impact on families most at risk of deterioration of relationship quality and breakdown.</li> </ul>					
<b>Equalities impacts</b>	This policy is about ensuring the appropriate payment of corporate taxation and only impacts the companies that are parties to a takeover, their shareholders and creditors. The policy does not affect service users, employees or the wider community. The policy does not relate to an area with known inequalities, and there are no specific or differential impacts on people with protected characteristics. <sup>8</sup>					

<sup>6</sup> HM Government (2014), Autumn Statement Policy Costings, December 2014, page 34

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/382330/AS2014\\_Policy\\_costings.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/382330/AS2014_Policy_costings.pdf)

<sup>7</sup> For more information see DWP (2014), 'The Family Test: Guidance for Government Departments', October 2014,

[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/368894/family-test-guidance.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/368894/family-test-guidance.pdf)

<sup>8</sup> For more detail on protected characteristics see <http://www.legislation.gov.uk/ukpga/2010/15/section/4>

Impact	Description
<p><b>Impact on business including civil society organisations</b></p>	<p>Parties to a takeover, which might previously have used a ‘cancellation’ scheme of arrangement, will in general now be expected to structure the takeover as a ‘transfer’ scheme of arrangement or a contractual offer, leading to a 0.5% stamp tax liability on the value of the takeover transaction. The degree of impact this additional charge will have on takeover activity cannot be assessed with certainty, but it would appear unlikely to have a significant constraining effect in the context of the wider costs involved, notably those associated with the actual integration of the businesses concerned (which a 2014 EY survey estimated at 14% of a takeover bid).<sup>9</sup></p> <p>There will be familiarisation costs for companies who would have conducted takeovers using ‘cancellation’ schemes of arrangement; and for businesses (e.g. investment banks, accountants, lawyers) that provide merger and acquisition advice to UK companies. It has not been possible to quantify these cost due to the absence of robust data on the amount of time required for the staff concerned to familiarise themselves with the revised regulations.</p> <p>There will also potentially be some costs arising to any companies who had been planning to use a ‘cancellation’ scheme of arrangement, but now choose to revise their takeover plan. These costs will be a mix of internal staff time, and costs associated with obtaining external professional advice on revisions to their takeover plans. It has not been possible to quantify these costs due to lack of robust data on both the number of companies that would be so affected and, as above, the amount of staff time that would be involved.</p> <p>This measure is not expected to have any impact on charities. The Annex provides further detail on the analysis of the impact of the measure on business, including a more detailed summary of the literature on the costs businesses incur in takeovers.</p>
<p><b>Operational impact (£m)</b></p>	<p>There are not expected to be any significant operational costs to government from implementing this change.</p>
<p><b>Other impacts</b></p>	<p><b>Small and Micro Business Assessment:</b> Takeovers via ‘cancellation’ schemes of arrangement are more commonly used for takeovers of large or medium sized companies than smaller companies. Merger and acquisition advice typically comes from larger, more specialised businesses rather than small or micro businesses.</p> <p>Other impacts (including environmental impacts) of implementing this measure compared to not taking action have been considered and none have been identified.</p>

<sup>9</sup> EY integration survey: The right combination: Managing integration for deal success’  
[http://www.ey.com/Publication/vwLUAssets/EY\\_Merger\\_Integration\\_Survey\\_the\\_right\\_combination/\\$FILE/EY-Merger-Integration-Survey-the-right-combination.pdf](http://www.ey.com/Publication/vwLUAssets/EY_Merger_Integration_Survey_the_right_combination/$FILE/EY-Merger-Integration-Survey-the-right-combination.pdf)

## Monitoring and evaluation

The government will monitor on an on-going basis the impact of this measure after its introduction, and discuss with key stakeholders the effects the change has had. It is proposed to conduct a formal review of the measure's impact within 5 years of the regulations' taking effect, though the Government will in the interim monitor the behavioural response of businesses engaging in takeovers.

In line with the Better Regulation Framework Manual<sup>10</sup> the review of the regulations will establish whether, and to what extent, the proposed measure has achieved its original objectives. It will also consider whether the objectives are still valid, whether the measure is still required and the best option for achieving those objectives and, if so whether the measure can be improved to reduce burdens on businesses.

Other key questions for a review to address are:

- To what extent have there been unintended consequences?
- What are the costs and benefits, in hindsight and going forward?

## Further advice

If you have any questions about this change, please contact:

- Aziz Yusuf, [aziz.yusuf@bis.gsi.gov.uk](mailto:aziz.yusuf@bis.gsi.gov.uk), 020 7215 6524.
- Andrew Ward, [andrew.ward@bis.gsi.gov.uk](mailto:andrew.ward@bis.gsi.gov.uk), 020 7215 0163

## Declaration

Jo Swinson MP, Parliamentary Under-Secretary of State for Employment Relations and Consumer Affairs has read this Information and Impact Note and is satisfied that, given the available evidence, it represents a reasonable view of the likely costs, benefits and impacts of the measure.

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<sup>10</sup> BIS (2013), 'Better Regulation Framework Manual: Practical Guidance for Officials', July 2013  
[https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/211981/bis-13-1038-better-regulation-framework-manual-guidance-for-officials.pdf)

## ANNEX

### Evidence Base

#### 1) Background to the policy proposal

There are a number of ways in which companies can enact a takeover:

- A contractual offer, where the acquiring company offers to buy the shares of the target company. If 90% of the target company's shareholders accept the offer then the remaining shareholders are legally obliged to sell their shares to the acquiring company.<sup>11</sup>
- A 'transfer' scheme of arrangement, where shares in the target company are transferred under a Court Order to the acquiring company in return for consideration in the form of cash, loan notes or shares.
- A 'cancellation' scheme of arrangement, where the Court authorises the target company to cancel its share capital and issue new shares to the acquiring company, again in return for consideration.

Stamp tax on shares is ordinarily payable on purchases of shares in UK registered companies, including in connection with takeovers. On both a contractual offer and a 'transfer' scheme stamp tax on shares is payable at 0.5% of the consideration paid for the shares. However, stamp tax is not currently payable on a 'cancellation' scheme, because taxation of the new share issues and certain transactions deemed to be 'restructuring operations' is prohibited by the EU Capital Duties Directive (2008/7/EC).

#### 2) A description of the proposed policy options

As announced at Autumn Statement 2014, the Government plans to amend the Companies Act 2006 through a set of regulations to prohibit a company from reducing its share capital as part of a scheme of arrangement where the purpose is to implement a takeover. This measure will affect takeovers in relation to which a 'firm offer' announcement (as required by the Takeover Code) is made on or after the day the statutory instrument is made, which is expected to be in early 2015. For companies not subject to the Takeover Code, the regulations will not apply to any takeover where the terms of the takeover have been agreed between the parties before the regulations come into force.

Below some alternatives options are discussed:

- The status quo (i.e. the 'Do Nothing' option) is not considered desirable since it would fail to prevent the inconsistency of treatment which arises on a takeover, depending on what mechanism is used to effect it.
- The option of applying a tax charge directly to 'cancellation' schemes was considered but rejected due to potential legal constraints arising from the EU Capital Duties Directive (2008/7/EC).

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<sup>11</sup> Further details can be found at <http://www.legislation.gov.uk/ukpga/2006/46/part/28/chapter/3>



- The option of removing stamp tax on shares on transfer schemes was considered, but the government is clear that stamp tax on shares should be payable on takeovers completed by scheme of arrangement, and does not favour equalisation of tax treatment by removing stamp tax on shares on ‘transfer’ schemes due to the negative impact this would have on government revenues.

There are recognised commercial reasons for a company opting to use a scheme of arrangement instead of a contractual offer in a takeover of another company.<sup>12</sup> Therefore it is not proposed to make changes that would affect the use of ‘transfer’ schemes in takeovers. Moreover ‘cancellation’ schemes will still be available for purposes other than takeovers – for example debt restructurings and intragroup reorganisations.

### **3) Rationale for government intervention: what is the problem under consideration? Why is government intervention necessary?**

The Government’s objective is to ensure that parties implementing takeovers are subject to stamp tax on shares, however they are carried out. There are both economic and equity (or fairness) rationales for prohibiting ‘cancellation’ schemes to achieve this objective.

Currently, stamp tax can be avoided by effecting takeovers through a ‘cancellation’ scheme of arrangement rather than an alternative takeover mechanism that pays stamp tax, such as a ‘transfer’ scheme or a contractual offer.

The measure will raise additional tax revenue that can be used towards providing public services (i.e. public goods such as roads, national defence); re-distributed through benefits, tax credits or subsidies; or used to meet the government’s fiscal mandate.<sup>13</sup>

There are equity or fairness arguments for ending the inconsistency of treatment.

- All companies involved in takeovers should arguably pay the same tax, regardless of the mechanism through these are put into effect; and
- Not paying tax on takeovers could give some companies an unfair competitive advantage over other companies that do.

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<sup>12</sup> Only 75% of the target shareholders are required to agree to the deal to force the remaining 25% to sell – compared to a contractual offer where 90% of shareholders are required to force a sale.

<sup>13</sup> See HM Treasury (2014), Charter for Budget Responsibility: Autumn Statement 2014 Update [https://www.gov.uk/government/uploads/system/uploads/attachment\\_data/file/386973/charter\\_for\\_budget\\_responsibility\\_AS2014\\_web.pdf](https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/386973/charter_for_budget_responsibility_AS2014_web.pdf)

#### 4) Analysis of the impact of the proposed policy on businesses and shareholders

The counterfactual for this analysis is to compare the impact of the proposed option to the status quo or 'Do Nothing' option (where 'cancellation' schemes are not prohibited).

##### Impact on business (including small and micro-businesses)

Number of businesses affected

*Number of takeovers using 'cancellation' schemes of arrangement*

The change in the law will impact on the businesses acquiring or merging with another business using 'cancellation' schemes. Recent data provided by the Takeover Panel - in the table below - outlines the number of 'cancellation' schemes that the Takeover Panel is initially notified about, and the number of schemes that subsequently complete.<sup>14</sup> The difference between the numbers is the number of lapsed bids and the number of non-UK bids.

*Table 1: Number of 'cancellation' schemes of arrangement*

Financial Year	Total 'cancellation' schemes of arrangement Takeover Panel notified	Total number of 'cancellation' schemes of arrangement completed
2012-13	28	24
2013-14	23	20

*Source: Takeover Panel*

It is possible past data may be an inaccurate guide to the number of takeovers that would have potentially used 'cancellation' schemes in future. The state of the economy;<sup>15</sup> confidence in the mergers and acquisitions market;<sup>16</sup> and availability of credit and company profits<sup>17</sup> are some of the main factors that can affect the number of acquisitions – and therefore the number of 'cancellation' schemes. Evidence suggests:

- The UK economy is expected to grow in 2015 at a rate of 2.5 per cent, and continue growing in future years (though at an uneven pace).<sup>18</sup>
- There is some appetite amongst Chief Financial Officers (CFOs) to use mergers and acquisitions to expand their businesses in future.<sup>19</sup>
- Corporate credit conditions have improved and there is a growing desire among some companies to increase their capacity.<sup>20</sup>

<sup>14</sup> The Takeover Panel is an independent body, whose main functions are to issue and administer the City Code on Takeovers and Mergers (the "Code") and to supervise and regulate takeovers and other matters to which the Code applies. Its central objective is to ensure fair treatment for all shareholders in takeover bids. For more information see <http://www.thetakeoverpanel.org.uk/>

<sup>15</sup> ONS (2014), 'Mergers and Acquisitions Involving UK Companies, Q1 2014', [http://www.ons.gov.uk/ons/dcp171778\\_365574.pdf](http://www.ons.gov.uk/ons/dcp171778_365574.pdf)

<sup>16</sup> ONS (2014), 'Mergers and Acquisitions Involving UK Companies, Q1 2014', [http://www.ons.gov.uk/ons/dcp171778\\_365574.pdf](http://www.ons.gov.uk/ons/dcp171778_365574.pdf)

<sup>17</sup> ONS (2014), 'Mergers and Acquisitions Involving UK Companies, Q3 2014', [http://www.ons.gov.uk/ons/dcp171778\\_387538.pdf](http://www.ons.gov.uk/ons/dcp171778_387538.pdf)

<sup>18</sup> Office for Budget Responsibility (2014), 'Economic and fiscal outlook – December 2014', <http://budgetresponsibility.org.uk/economic-fiscal-outlook-december-2014/>

<sup>19</sup> Deloitte (2014), 'The Deloitte CFO Survey Q3 2014: Risk Appetite at a New High', <http://www2.deloitte.com/content/dam/Deloitte/uk/Documents/finance/cfo-survey-2014-q3.pdf>

There is a possibility that strong economic growth; improving business sentiment and performance; and the greater availability of finance, could mean more takeovers in future than in the past. If so the costs to business of the proposed regulatory change would increase, as more businesses would be affected.

### *Number of businesses advising on takeovers*

There are a number of businesses affected by the proposed regulatory change in addition to the companies directly involved in takeovers. These are businesses that are involved in providing advice on takeovers. These include, but are not limited to:

- businesses offering legal advice to companies;
- consultancies;
- investment companies;
- banks;
- financial advisers and intermediaries; and
- accountancy firms;

Data on the total number of these businesses that are currently involved in providing advice on takeovers are limited, as there is no official data source or registry that covers these companies. However Merger Market's UK merger market report for the first half of 2014 provides data on the level of merger and takeover deal activity by such businesses in the UK.<sup>21</sup> The markets for such advice appear heavily concentrated, and a small number of specialised businesses are involved in providing financial and/or legal advice across a sizeable portion of the UK's mergers and acquisitions. In the first half of 2014 the top 15 financial advisers in the UK were involved in 346 merger and acquisition deals and the top 15 UK legal advisors were involved in 459 merger and acquisition deals.<sup>22</sup>

## **Costs to business**

### *Familiarisation costs*

Companies involved in a scheme of arrangement, and businesses that advise on takeovers, will incur familiarisation costs making themselves aware of the implications of this change in regulation.

### *Familiarisation costs to companies involved in a scheme of arrangement*

It is assumed that the familiarisation is undertaken by lawyers within companies, and by company directors and owners. The companies using 'cancellation' schemes of arrangement are likely to be larger companies that pay their staff more than average. The table below shows hourly wage data for these two professions from the Annual Survey of Hours and Earnings 2013 (updated into 2015

<sup>20</sup> Bank of England (2014), 'Agents' Summary of Business Conditions - September 2014', <http://www.bankofengland.co.uk/publications/Pages/agentssummary/2014/agsum14sep.aspx>

<sup>21</sup> Merger Market (2014), UK M&A Trend Report: H1 2014, See <http://www.mergermarket.com/pdf/MergermarketTrendReport.H12014.UK.pdf>

<sup>22</sup> Deals where the UK was the dominant geography of the target, bidder or seller company.

prices using HMT GDP Deflators<sup>23</sup>, and uplifted for non-wage labour costs<sup>24</sup>) at different points in the wage distribution.<sup>25</sup> This gives an indication of the value of time of staff potentially involved in familiarisation with the new regulations.

*Table 2: Value of an hour's time - professionals that could be involved in familiarisation with new regulations*

	<b>Median Wage</b>	<b>75<sup>th</sup> Percentile</b>	<b>90<sup>th</sup> Percentile</b>
Legal Professional	£28.10	£42.80	£68.60
Corporate Owner/Director	£25.30	£39.10	£59.30

*Source: Annual Survey of Hours and Earnings Revised Results 2013*

It is likely that only companies who would potentially be involved in a 'cancellation' scheme would need to become familiar with the new regulations after the proposed regulatory change. They would normally need to consult the regulations to ensure that they are compliant. They will thus need to consult the changed regulations to ensure they are following the rules when involved in a takeover. Companies not likely to be involved in a takeover are not likely to consult the regulations, and therefore are not expected to need to familiarise themselves with the new regulations.

As previously stated our best estimate of the annual number of 'cancellation' schemes that would have occurred in future years is 22 - the mid-point between the 2012-13 and 2013-14 figures for 'cancellation' schemes rounded up to the nearest whole number. The number of affected companies will be 44 (as schemes involve both an acquiring and an acquired company).

However it has not been possible to quantify the familiarisation costs that these companies will face as we lack robust data on how long it will take company staff to familiarise themselves with the revised regulations. We lack comparable data from other regulatory analysis, and have not been able to consult companies directly. It seems reasonable to assume, however, that these familiarisation costs will be negligible in comparison to the wider administrative and managerial costs associated with the preparation of a takeover or merger (see 'Brief Summary of the Evidence on the Costs to Business of Takeovers' on page 12).

#### *Familiarisation costs to businesses that advise on takeovers*

As previously stated we lack data on the number of businesses that provide advice on takeovers. This activity – and therefore the familiarisation costs associated with the proposed regulatory change - will likely be concentrated amongst a number of specialist businesses who advise on many acquisitions in the UK.

<sup>23</sup> HM Treasury (2014), 'GDP deflators at market prices, and money GDP: September 2014 (Quarterly National Accounts)', <https://www.gov.uk/government/statistics/gdp-deflators-at-market-prices-and-money-gdp-september-2014-quarterly-national-accounts>

<sup>24</sup> Non-wage labour costs e.g. National Insurance contributions and pensions. Eurostat data estimates these costs at 18.1% of wages. See [http://europa.eu/rapid/press-release\\_STAT-13-54\\_en.htm?locale=en](http://europa.eu/rapid/press-release_STAT-13-54_en.htm?locale=en)

<sup>25</sup> ONS (2014), ASHE Revised Results 2013, Table 14.5a

*Costs to companies planning or undertaking a takeover*

Data from the Takeover Panel suggests that in 2013-14 on average, for ‘cancellation’ schemes, it took just under 3 months from the announcement of the start of takeover talks to the announcement of an offer. Therefore there are likely to be some companies that have begun talks on a takeover, and drawn up plans to put it into place using a ‘cancellation’ scheme, but will not be able to: a) announce a ‘firm offer’ on or after the day the statutory instrument is made, which is expected to be in early 2015; (companies subject to the Takeover Code); or b) agree the terms of the takeover before the regulations come into force; (companies not subject to the Takeover Code).

These companies will be a subset of the companies who use ‘cancellation’ schemes each year (of which there were 24 in 2013-14 and 20 in 2012-13). We have not been able to quantify the additional costs these companies may face because:

- We lack data on the number of relevant deals currently in progress; and
- We lack of robust evidence on how long it will take to review plans for a takeover after the regulatory proposal is enacted.

Key uncertainties over numbers include:

- Lack of evidence on how many takeovers are currently being planned.
- The fact that some companies could have reacted to the Autumn Statement’s announcement of an intention to prohibit ‘cancellation’ schemes in takeovers by bringing forward their plans, and making ‘firm offers’ or agreeing terms more quickly.

Where companies do have to revise takeover plans, we would assume that corporate directors and owners in target companies and acquiring companies and both internal and external legal professionals would be involved in the planning the takeover. Therefore where plans are reviewed costs would be internal administrative costs and fees for external advice. A key uncertainty is whether the reviewing of plans would be a short task, drawing on existing advice or information received about different mechanisms that was compiled when originally deciding to undertake a ‘cancellation’ scheme; or whether it would be a more burdensome task requiring a significant amount of new work for companies and their advisers.

For these reasons this cost to business has not been quantified. However it will impact on only a small number of companies (whose number is limited by transitional arrangements the regulations put in place).

## Summary of costs to business

Table 3: Summary of costs to business

Cost to business	Description
Familiarisation costs to companies involved in 'cancellation' schemes of arrangement (non-monetised)	Time for legal professionals and corporate owners and directors to familiarize themselves with the new regulations.
Familiarisation costs to businesses involved in providing merger and acquisition advice (non-monetised)	Time for staff within these businesses to familiarize themselves with the new regulations.
Costs for companies that need to review their merger and takeover plans (non-monetised)	Internal staff time, and external advice fees, involved in a company reviewing its in-progress plans to effect a takeover using a 'cancellation' scheme of arrangement.

## Benefits to business

The main benefits of the proposed option are to the exchequer and society (where the exchequer puts the increased tax revenue to socially beneficial uses). There may be some non-monetised benefits to business. In principle companies will no longer be able to gain an unfair competitive advantage over other companies by avoiding paying stamp tax on shares on takeovers through a 'cancellation' scheme.

## Impact on small and micro businesses

We lack data on the size of companies involved in takeovers using 'cancellation' schemes of arrangement that could be used to do a quantified assessment of the effect this proposed policy has on small and micro businesses. However, data held by the Takeover Panel, suggests that schemes involving 'cancellation' schemes in 2013-14 are frequently valued in the tens of millions of pounds - and some deals are of the magnitude of hundreds of millions or billions of pounds.

Some smaller firms may be involved in advising on acquisitions and thus incur familiarisation costs as a result of the proposed change. However evidence presented earlier suggests that this market is heavily concentrated amongst larger firms who operate across many deals.

Therefore, overall, it is unlikely that small and micro businesses will be affected by the proposed regulatory change.

## Impact on shareholders of companies involved in takeovers

### *Benefits*

If prohibiting 'cancellation' schemes of arrangements was in future to lead to more companies to make contractual offers rather than enacting schemes, then there would be possibly be non-monetised benefits in terms of increased information for affected shareholders and could increase these shareholders' ability to prevent a takeover or slow it down. However, we cannot be certain

on the basis of current evidence that companies will necessarily move to making contractual offers (as opposed to ‘transfer’ schemes).

### Costs

Anecdotal evidence suggests that due to the lack of stamp tax on deals effected through ‘cancellation’ schemes, the target company’s shareholders, may seek a larger consideration for the bidder than if stamp tax was payable. To the extent this practice occurs, prohibiting ‘cancellation’ schemes in takeovers will end it. This cost has not been monetised.

It is possible that once the legislation is enacted bidding companies may seek to recoup some of the tax they will incur by paying a lower price than they otherwise would have for the target company’s shares. This cost has not been monetised.

In certain potential takeover structures (specifically, one in which the bidder prefers to use as consideration shares issued by another group company) the change may have some impact on the availability of capital gains tax deferral reliefs to UK resident shareholders under Section 136 Taxation of Chargeable Gains Act 1992. We lack reliable data on the frequency of these types of deal structures. However discussions with market contacts indicate that this impact will be minimal due to the availability of other forms of relief, and of alternative deal structuring options. Therefore, this cost has not been monetised.

## Brief Summary of the Evidence on the Costs to Business of Takeovers

This section provides a brief literature review on the most recent evidence in the costs to businesses involved in taking over another company.

Many costs can arise in the process of a takeover, and these costs are uncertain. For example companies can incur costs relating to:

- Merger and acquisition advisory fees from investment banks managing the deal and lawyers;
- Fees to the Takeover Panel;
- Fees to the Competition and Markets Authority;
- The premium paid on shares when acquiring a company;
- Costs in notifying and gaining shareholder approval for the deal; and
- The costs of merging business functions, such as IT etc;

This list of costs is illustrative rather than exhaustive. The evidence base behind these costs is outlined in the rest of this annex. Overall the available evidence suggested that the costs of a takeover can be significant: Cole et al. (2010) found that the average international cost of a merger or acquisition is \$5.2m, or £3.3m.<sup>26</sup>

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<sup>26</sup> RA Cole, KR Ferris & A Melnik (2010) ‘The Cost of Advice in Merger and Acquisition Transactions’, <http://ssrn.com/abstract=1458465>



## Merger and Acquisition Advisory Fees

Merger and acquisition advisory work is a bespoke product with variation in fees for comparable transactions. Cole, et al (2010) points out that this advice can cover topics such as advice on the structure of a proposed merger and acquisition; advice on financing the deal, and strategic advice concerning the integration of the acquiring firm and its intended target. This study found that the cost of merger and acquisition advice increases with the financial size of the intended transaction, and increases the more complex an acquisition. For example the authors find that international acquisitions are more expensive to advise on than domestic takeovers, as are takeovers that involve an exchange of several types of assets.

Press reports place fees at around 0.5%, although some can be as high as 2%.<sup>27</sup> Older evidence suggested that between 1978 and 1985 fees averaged 1.3% of the value of transactions.<sup>28</sup> There are also likely to be legal fees arising from external legal advisors.

## Takeover Panel Fees

The Takeover Panel is an independent body who issues and administers the City Code on Takeovers and Mergers and supervises and regulates takeovers, its role is to ensure that all shareholders are treated equally during takeover bids. All takeovers are scrutinised by the panel. Fees vary from 0.2% for small deals to 0.02% for large ones.<sup>29</sup> The table below outlines the charges in full detail.

Table 4: The Takeover Panel's Fees and Charges

Value of the offer £ million	Charge (£)	Charge as a maximum % of the value of the offer
1 to 5	2,000	0.20%
Over 5 to 10	8,500	0.17%
Over 10 to 25	14,000	0.14%
Over 25 to 50	27,500	0.11%
Over 50 to 100	50,000	0.10%
Over 100 to 250	75,000	0.08%
Over 250 to 500	100,000	0.04%
Over 500 to 1,000	125,000	0.03%
Over 1,000	175,000	0.02%

Source: <http://www.thetakeoverpanel.org.uk/the-code/fees-and-charges>

<sup>27</sup> <http://www.theguardian.com/business/2014/may/19/pfizer-astrazeneca-bid-collapse-bankers-lose-jackpot-fees>

<sup>28</sup> RM McLaughlin (1990) "Investment banking Contracts in tender offers" Journal of Financial Economics 28 (1990) 209

<sup>29</sup> <http://www.thetakeoverpanel.org.uk/the-code/fees-and-charges>



## Competition and Markets Authority Fees

The Competition and Markets Authority may charge fees to investigate a takeover if they believe there are competition implications. Most takeovers which are investigated by the CMA and those which qualify for a reference to Phase 2 are subject to a fee, irrespective of whether a reference is made.<sup>30</sup> Fees vary according to the value of the UK turnover of the business being acquired, and are outlined in the table below.<sup>31</sup>

Table 5: Competition and Markets Authority Fees

Fee	Charge Band
£40,000	Value of the UK turnover of the enterprises being acquired is £20 million or less
£80,000	Value of the UK turnover of the enterprises being acquired is over £20 million but not over £70 million
£120,000	Value of the UK turnover of the enterprises being acquired exceeds £70 million, but does not exceed £120 million
£160,000	Value of the UK turnover of the enterprises being acquired exceeds £120 million

Source: <https://www.gov.uk/mergers-how-to-notify-the-cma-of-a-merger>

## Bid Premium

Press reports place bid premiums in the approximate region of 20-30% over the background price of a stock<sup>32</sup>.

## Costs in notifying and gaining shareholder approval for the deal

Gruidl and Tucker (2010)<sup>33</sup> note that the acquiring company incurs costs in notifying and gaining shareholder approval for the deal.

## Cost of merging business functions

It is hard to estimate the costs of merging business functions, which will vary widely from company to company. For example, EY estimate from a survey of 200 executives in 2014 that costs on average are 14% of the bid, with 84% of executives estimating between 10 and 15%, and none estimating less than 5%.<sup>34</sup> Most executives found they have underestimated these costs before their deal.

<sup>30</sup> Phase 1 is an investigation to establish whether there is a realistic prospect that a qualifying merger will cause a substantial lessening of competition within 1 or more markets in the UK or part of it. In a Phase 2 investigation the CMA conducts a more detailed analysis to determine whether the proposed merger qualifies as a relevant merger and, if so, has resulted, or may be expected to result in a substantial lessening of competition.

<sup>31</sup> <https://www.gov.uk/mergers-how-to-notify-the-cma-of-a-merger>

<sup>32</sup> <http://www.ftpress.com/articles/article.aspx?p=2109325&seqNum=4>

<sup>33</sup> [http://mcgladrey.com/content/dam/mcgladrey/pdf/merger\\_acquisition\\_transaction\\_costs-who\\_gets\\_the\\_benefit.pdf](http://mcgladrey.com/content/dam/mcgladrey/pdf/merger_acquisition_transaction_costs-who_gets_the_benefit.pdf)

<sup>34</sup> EY integration survey: The right combination: Managing integration for deal success'

[http://www.ey.com/Publication/vwLUAssets/EY\\_Merger\\_Integration\\_Survey\\_the\\_right\\_combination/\\$FILE/EY-Merger-Integration-Survey-the-right-combination.pdf](http://www.ey.com/Publication/vwLUAssets/EY_Merger_Integration_Survey_the_right_combination/$FILE/EY-Merger-Integration-Survey-the-right-combination.pdf)

Merging business functions can give rise to savings for businesses. For example McKinsey evidence suggests that 10 to 15 per cent cost savings can be delivered by successful IT integration after a merger and acquisition.<sup>35</sup>

Gruidl and Tucker (2010)<sup>36</sup> find that there can be costs arising as a result of property transfers between the parties of the merger and acquisition.

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<sup>35</sup> McKinsey (2010), 'Understanding the strategic value of IT in M&A'

[http://www.mckinsey.com/insights/corporate\\_finance/understanding\\_the\\_strategic\\_value\\_of\\_it\\_in\\_m\\_and\\_38a](http://www.mckinsey.com/insights/corporate_finance/understanding_the_strategic_value_of_it_in_m_and_38a)

<sup>36</sup> [http://mcgladrey.com/content/dam/mcgladrey/pdf/merger\\_acquisition\\_transaction\\_costs-who\\_gets\\_the\\_benefit.pdf](http://mcgladrey.com/content/dam/mcgladrey/pdf/merger_acquisition_transaction_costs-who_gets_the_benefit.pdf)



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