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Schemes of Arrangement in UK Public M&A: High Court Declines to Apply the Ramsay Principle

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The High Court recently decided that a scheme of arrangement involving the reduction of capital prior to a takeover did not breach targeted anti-avoidance rules contained in the Companies Act.

Legislative Background

Targeted anti-avoidance rules were introduced in 2015 to prevent capital reductions being effected prior to a takeover as a method of avoiding stamp duty on the purchase of shares.

The rules aim is to combat the previously popular method to implement a recommended takeover by way of a cancellation scheme of arrangement. Under a cancellation scheme, shareholders whose shares were cancelled were compensated by the purchaser of the company and the shares were then re-issued by the target company in favour of the purchaser. As opposed to a transfer of shares, a share issue does not attract stamp duty.

The rules introduced in 2015 prohibit a company from reducing its capital as part of a scheme of arrangement the purpose of which is the acquisition of all the shares in the company.

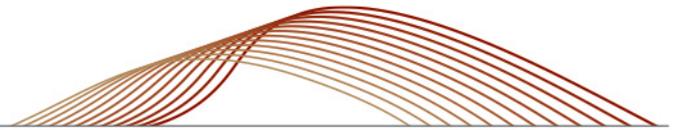
There is, however, an exception to the prohibition where the scheme of arrangement is part of a restructuring which results in the insertion of a new parent holding company and all, or substantially all, of the members of the company acquire shares in the parent company in substantially the same proportion they held in the company (the "s.641(2B) Exception").

The application of this exception was the focus of the present case.

Facts

Home Retail Group plc ("HRG") announced that it planned to dispose of its Homebase business and intended to make a capital return to its shareholders. Prior to the disposal, HRG reached an in principle agreement on a takeover by J Sainsbury plc ("Sainsburys"). The consideration offered by Sainsburys took into account the capital return announced by HRG and meant they did not need to raise additional financing to acquire the cash that was due to be returned to the shareholders. Additionally, this also meant the transaction was below the Class 1 threshold.

The transaction would involve a scheme of arrangement pursuant to which a new parent holding company ("Newco") would be formed with HRG's existing shareholders acquiring shares in the Newco in substantially the same proportion they hold in HRG. The Newco would then undergo a capital reduction in order to return the capital to the shareholders and the Newco shares would subsequently be compulsorily transferred to Sainsburys.



HRG sought confirmation from the Court that the scheme should not be prohibited on the basis that the s.641(2B) Exception applied.

Decision

Having regard to the interpretation of the legislation, the Court considered whether the Ramsay principle should be applied.

In summary, the Ramsay principle requires a purposive approach to the interpretation of tax legislation requiring the courts to analyse the intent behind the legislation and apply this purposive construction to the facts of the transaction.

Favouring a literal interpretation of the legislation, the Court did not confirm whether the Ramsay principle applied to s.641(2B) CA 2006. It would have been interesting to see if the courts would have applied a tax principle to the interpretation of company legislation. It was however noted that even if the Ramsay principle was applied, the facts of this case indicated the use of the cancellation scheme was part of a true commercial transaction with a clear business purpose.

Comment

With HMRC consistently seeking to use the Ramsay principle as a fall back to challenge arrangements it considers abusive, this is a welcome decision which helps define the boundaries and limitations of the Ramsay principle and provides comfort to companies seeking to use exceptions within the legislation to achieve bonafide commercial goals especially as part of complex M&A acquisition structures.



If you have any questions concerning these developing issues, please do not hesitate to contact any of the following Paul Hastings London lawyers:

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