Corporate

Burges Salmon

Burges Salmon Guide to group reorganisations and corporate simplifications

Contents

- Introduction 3
- Why carry out a reorganisation? 4
- What's involved? 5
- What should you watch out for? 7
- Other key issues 7
- Key contacts 11

Introduction

This guide provides an overview of group reorganisations and corporate simplifications. It covers the reasons why reorganisations are carried out, the process involved and some of the key issues which need to be considered in the context of a reorganisation.

A reorganisation usually involves the transfer of assets, which may be shares in another group company or the business of another group company, from one group company to another.

Why carry out a reorganisation?

There are a number of reasons as to why a reorganisation may be implemented. Common reasons for group reorganisations are:

- **To simplify the corporate structure of the group:**

  a period of significant acquisitions or the use of special purpose vehicles can result in a group structure which is too complex for current requirements. Alternatively, it may be that elements of a group's businesses are carried out by a number of companies, and the group wants to rationalise its structure so that the elements of each trade sit in one company. A group may also consist of companies in a number of countries and an overseas parent may wish to simplify its UK structure.

  A complex group structure can:

  – bring significant additional costs to the business;

  – absorb significant amounts of management time; and

  – have an impact on how a group is viewed by HMRC.

  The benefits of simplifying a large structure include:

  – fewer companies to manage and more time to focus on business issues;

  – reduced complexity in the group structure could improve the group's risk rating with HMRC;

  – lower compliance costs; and

  – simplified reporting structure.

- **A pre-step for a sale of the group or part of the group:**

  the objective may be to simplify the corporate structure (e.g. remove dormant companies from the group) to make it more attractive to a buyer, or commonly a reorganisation may be appropriate where the group (or a company) only wishes to sell part of its business. For example, if a company carries on a number of trades and only some are to be sold, then as a pre-step those trades could be "packaged" into a stand-alone subsidiary which is then sold to the buyer.

- **After an acquisition:**

  following an acquisition it may be necessary for the acquiring group to move the purchased assets around its group to ensure they are in the most appropriate subsidiary. For example, this may involve the transfer (commonly known as a hive-up or hive down) of businesses to other group companies, or the target group or company being transferred to a holding company in the group if it was not the acquirer.

- **In preparation for an acquisition:**

  the acquiring group may want to restructure in advance of an acquisition so that the target group/business can easily fit into the acquiring group's structure.

What's involved?

Typically a corporate simplification project is split into the following stages:

1. **Planning:**

   Planning, discussion with stakeholders and appointing advisers (typically legal and tax).

2. **Due diligence (accounting, legal and tax):**

   The focus here is on assessing whether there are any company specific issues which could have an impact on the proposed simplification project. Examples include:

   – the availability of distributable reserves;

   – the terms of any regulatory approvals, licences or permissions; and

   – third party consent requirements.

   The due diligence process also identifies the assets which need to be transferred from any companies which have been selected for strike-off.

3. **Steps plan:**

   An overall plan for the simplification project is developed which sets out the key objectives and primarily considers the tax implications of the proposed steps. The plan will commonly split out each of the group companies which are to be part of the project, and this may range from simple dormant companies which can be eliminated without further additional work to key trading companies which must be retained. A more detailed plan is then produced for the project and this contains detailed steps for each company to take before it is eliminated. It also sets out the relevant legal documents which need to be prepared and executed for each step.

4. **Approvals:**

   Once a detailed plan has been developed and before any steps are taken to simplify the group, all relevant approvals/consents/clearances should be obtained. Bank and shareholder consent may be required.

5. **Business/asset transfers:**

   Business/asset transfer agreements will be used to transfer businesses/assets from those companies which are being eliminated to the companies which are being retained in the group structure.

– Price: These transfers normally take place at book value using the carrying value shown in the company's accounts (assuming that the company transferring the assets has distributable reserves). In other circumstances the transfer must take place at market value. Advice should be taken as to what value is used for each transfer.
– Tax: The tax treatment of any business/asset transfer should also be considered. If both companies are in the same group for tax purposes, then it is likely that the transfers can be undertaken on a tax neutral basis.

  However, particular attention needs to be paid to the consequences, later on, of such tax neutral treatment (e.g. there might be a claw back of the tax saved if the relevant companies are de-grouped at some time in the future).

  Particular attention needs to be paid to VAT, the taxable status of the assets, VAT group arrangements, and the possibility of going concern treatment should be addressed.

6. Simplify balance sheets:

Commonly in relation to those companies which are targeted for strike off, steps are carried out beforehand to simplify their balance sheets. Typically this will involve capital reductions (where the companies have significant issued share capital/share premium), the declaration of dividends and/or steps to deal with intra-group balances.

7. Strike-off/liquidate companies:

For companies with a straightforward history or no trading history, strike off is probably the most cost-effective route. Liquidation using the members' voluntary liquidation procedure may be more appropriate for companies with a complex trading history.

Although a company can be struck off the register of companies, there are circumstances when it can be restored. Under the Companies Act 2006, an application can be made to the court for restoration of a company to the register for a period of six years from the date of the dissolution of the company (there is no time limit if the application relates to a personal injury claim).

What should you watch out for?

If you are planning a corporate simplification project then particular attention should be given to:

- tax and ensuring that none of the steps involved in the corporate simplification project trigger a tax liability (including stamp duty and stamp duty land tax) or result in the loss of tax reliefs;
- pensions if there is a defined benefit scheme within the group and participating employers (or the broader "employer covenant") may be affected; and
- ensuring that companies involved in the project have sufficient distributable reserves and are solvent.

In addition, directors should consider their duties to the company and corporate benefit issues at all stages of the project.

Other key issues to consider as part of the project include:

Availability of distributable reserves:

As part of stage 5 (business/asset transfers) it may be necessary to create distributable reserves in the company which is transferring assets. The availability of distributable reserves then means that the transfer can take place at book value.

Often the simplified capital reduction process for private limited companies will be used to create distributable reserves. The Companies Act 2006 enables private limited companies to reduce capital without the extra time and expense of the court procedure by way of:

- a directors' solvency statement; and
- a special resolution.

Under this procedure all the directors are required to state that they have formed the opinion that there is no ground on which the company could be found to be unable to pay its debts at the date of the statement and for the next 12 months. If the statement is made without reasonable grounds each director who is in default is guilty of an offence punishable by fine and/or imprisonment.

The reduction of capital takes effect when the relevant documents (solvency statement, special resolution and statement of capital) are registered at Companies House.

The Companies (Reduction of Share Capital) Order 2008 confirms that the reserve arising from the reduction of capital is (subject to some limited exceptions) to be treated as a realised profit.

Distributions in kind:

An intra-group transfer of assets to a parent company or fellow subsidiary at book value will need to comply with the rules relating to distributions in kind. Transfers at market value fall outside these rules.

Since the decision in the Aveling Barford case (Aveling Barford Ltd v. Perion Ltd [1989] BCLC 626) there was uncertainty as to whether an intra-group transfer of assets could be conducted by reference to the book value of the asset rather than its market value. The Aveling Barford case established that where a company does not have any distributable profits and transfers an asset to a shareholder at less than market value, the company will have made an unlawful distribution.

The uncertainty was resolved by the introduction of provisions in the Companies Act 2006 which provide that if a company which has profits available for distribution transfers a non-cash asset to a shareholder the amount of the distribution arising from the transfer of the non-cash asset is:

- zero if the consideration is equal to or exceeds the book value of the asset; or
- the amount by which the book value of the asset exceeds the consideration received. In this case, the difference must be covered by the company's distributable profits.

The company's distributable profits are deemed to be increased by the amount (if any) by which the amount paid exceeds the book value of the asset.

Appendix 1 of the ICAEW Guidance on realised and distributable profits under the Companies Act 2006 contains some worked examples of a transfer of an asset applying the provisions of the Companies Act.

TUPE:

An intra-group transfer of a business/assets and/or employees could trigger a transfer under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (TUPE). If TUPE applies, employees transfer on their existing terms, with continuity of service and with most pre-transfer liabilities. It will also be necessary to consider the extent to which an information and consultation process will be carried out. Under TUPE, the transferor is obliged to provide certain information to employees (or technically employee representatives). The relevant information comprises the fact that the transfer is proposed, the reasons for it, the expected date of it, the social, legal and economic implications of the transfer and details of any measures envisaged by the transferor or the transferee.

Pensions:

If any group company participates, or had formerly participated, in a defined benefit pension scheme then the relevant company may need to approach the pension trustees to explain the proposed group simplification project and the impact on the strength of the employer covenant.

Capital contributions:

In certain circumstances, a parent may need to make a capital contribution to a subsidiary. Examples of capital contributions include:

- a cash payment to the subsidiary which would involve the parent making a gift of the relevant sum to the subsidiary; or
- the parent waiving the right to receive an amount which is due and payable by the subsidiary.

The documents need to make it clear that:

- the parent has made a one off gratuitous payment;
- the capital contribution is not repayable;
- the parent does not receive any asset, right or consideration in return for the capital contribution; and
- the payment will be credited to the subsidiary's reserves as a capital contribution and not to the profit and loss account.

Clearance can be sought from HMRC if there is uncertainty surrounding the tax treatment of a capital contribution.

Although the description may suggest otherwise, a capital contribution does not involve the issue of new equity and the Companies Act 2006 does not refer to capital contributions. It follows that company law does not regulate the terms on which the contribution is made. Equally company law does not impose any restrictions on how the company can use the capital contribution which reflects the fact that the contribution is not part of the company's paid up share capital.

A key consideration is whether the contribution has resulted in the creation of a realised profit for the subsidiary. Reference should be made to the ICAEW Guidance on realised and distributable profits under the Companies Act 2006.

Demergers:

A demerger is the term used to describe the segregation of business activities which were initially held under common or related ownership. A demerger can be part of a corporate simplification process.

Where you have a company or a group of companies carrying out a number of trades, it may be advantageous to separate those activities by transferring each separate trade into a separate company. After the demerger, the shares in the company being demerged are commonly held by the same holders, in the same proportions as the shares they held in the company which has been demerged. However, the trades are now separated.

You can also have partition demergers, which usually refers to a demerger where the trades of the company being demerged are transferred to a new company whose shares are issued to one class of the demerged company's shareholders. The other trade (or trades) are transferred to another company which issues shares to the remaining shareholders (of the original demerged company). In other words, you end up with the original trades being held separately, with each trade being held by a company owned by some of the original shareholders of the demerged company. This type of demerger may occur for example when the assets of a company need to be separated following a shareholder dispute.

A demerger can take several forms, and specialist legal and tax advice should be obtained. It is not an issue we cover in detail in this guide. Please contact us if you would like further information.

Assets of a dissolved company:

If immediately before its dissolution a company holds any property and rights in which it has a beneficial interest, such property and rights will be deemed to be bona vacantia. This means the assets/property will pass to the Crown when the company is dissolved. It is therefore important to identify the assets of any company (e.g. properties, bank accounts, contracts) for which an application for strike off is proposed. If an asset is left in a company on strike off and passes to the Crown, this could cause material issues for the group. The process of due diligence (stage 2) is therefore an important one.

Key contacts

If you would like any further information on this subject please speak to your usual contact at Burges Salmon or:

Who to contact

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