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Group and Company Reorganisations

At some time during the development of a company the directors and shareholders are likely to see advantages in diversifying the ownership of business activities. There are many reasons why a reorganisation of a company's activities is desirable. More often than not the desire is either to protect one or more business activities or to divide business assets so that shareholders may go off in different directions.

The presence of potential tax liabilities can often be a deterrent. With careful planning, however, the commercial advantages of a reorganisation of business activities or shareholdings can be realised without triggering a significant (or in some cases any) tax bill.

There are two principal ways of achieving this - through a statutory demerger or by using Section 110 of the Insolvency Act 1986. Provided the necessary criteria are met, a statutory demerger can offer a relatively straightforward means of separating two trades. In our experience the criteria are such that most business separations are made using the provisions of Section 110.

In this Insolvency Briefing I explain how the insolvency legislation, using Section 110, allows businesses to achieve their goals in this area.

The commercial justification driving a reorganisation will often be a wish to separate the business assets or activities so as to minimise the risk to other parts of the business, or to allow shareholders to take a greater ownership in the part of the business they wish to develop. Equally, though, it is possible that the management want to sell part of the business, whilst retaining the remainder. Examples of reorganisations on which we have recently advised include:

- A typical (pyramid) group with three activities (pubs and restaurants, hotels and hotel management) was demerged into three separate groups reflecting the separate trades.
- Shareholders in a company owning nursing homes wished to separate the business assets between them so that they each could further develop part of the business, as they wanted. The

properties were separated out into new companies.

- A commercial property was split from a company's trading activity and transferred to a new company, so increasing the chances of a tax efficient sale of the trading business at a later date.
- A company carrying on two trades was approached by a potential purchaser who wanted only one of these trades. The trades were separated and the business wanted by the third party sold.

In all of these cases, the reorganisation involved a Section 110 liquidation.

Company reorganisations are fraught with tax issues. These include capital gains tax (CGT), income tax on potential distributions or employment related transfers (benefits in kind), inheritance tax (IHT) - if there is a gift transferring value between shareholders - and stamp duty land tax (SDLT).

The prospect of facing significant tax liabilities will often be a deterrent to a reorganisation, particularly for the smaller business. However, HM Revenue & Customs (HMRC) recognise the procedure under Section 110 and will give tax clearances (where possible), confirming that the reorganisation is being carried out for genuine commercial reasons and that the various tax reliefs associated with a reorganisation are available. Provided that the reorganisation then follows the route advised to HMRC, the tax liabilities should be kept to a minimum.

Under Section 110 a liquidator may, with sanction, receive shares, policies or like interests in a transferring company for distribution among the members of the transferor company.

Contact us:

London

The International Press
Centre
76 Shoe Lane
London
EC4A 3JB
Tel: +44 (0)20 7353 1597
Fax: +44 (0)20 7353 1748

St. Albans

72 London Road
St Albans
Hertfordshire
AL1 1NS
Tel: +44 (0)1727 869141
Fax: +44 (0)1727 869149

Milton Keynes

Silbury Court
420 Silbury Boulevard
Central Milton Keynes
MK9 2AF
Tel: +44 (0)1908 605552
Fax: +44 (0)1908 677433

Northampton

300 Pavilion Drive
Northampton Business Park
Northampton
NN4 7YE
Tel: +44 (0)1604 669330
Fax: +44 (0)1604 702000

A typical Section 110 scheme will involve the creation of a new holding company (Newco H), which will, as part of the reorganisation, be placed into liquidation. This has a number of benefits, including the fact that Oldco is not associated with the liquidation.

Existing shareholders will exchange their shares for the issue of shares in Newco H in proportion to their present shareholding. The assets of Oldco will then be reorganised into the appropriate segments that will make them easily transferrable out of the group. This is likely to involve either the transfer or distribution of assets or shares up to Newco H prior to liquidation.

Two or more new companies are then formed (Newco A and Newco B, etc). Newco H is placed into solvent liquidation and the liquidator tasked under Section 110 with distributing the assets of Newco H, in exchange for shares to be distributed to the shareholders of Newco H. The shareholdings in Newcos A, B etc need not necessarily be in the same proportion of the shareholdings in Newco H if, for example, the reorganisation is to enable shareholders to take ownership of different parts of the business. However, it will be critical, to avoid a tax charge, that

shareholders inherit shares with a value proportionate to their pre-reorganisation value.

Though comparatively rare, it is possible to carry out a Section 110 scheme or reorganisation without forming Newco H. However, creditors of the company to be liquidated will have to be settled either before or as part of the liquidation process.

There are some complicated tax rules where properties are being transferred and then leave a group, as well as SDLT considerations. Where the reorganisation involves properties, the tax planning and advice will be more involved.

In conclusion, the commercial justification to reorganise the business assets, activities or shareholders' interest within a company should not be frustrated by potential tax liabilities. HMRC recognise what can be achieved from a Section 110 reorganisation. Tax planning is critical, as is the drafting of the legal documentation covering the reorganisation.

If we can assist, advise or support with the assessment, planning and implementation of a company or group reorganisation, then please do not hesitate to contact us.

The Mercer & Hole Rescue, Recovery and Insolvency team has extensive experience covering the breadth of restructuring and recovery work. Our partners and managers have many years of experience helping companies and individuals facing financial problems.

Initial consultations are free of charge and without commitment.



Steve Smith

Head of Department
Partner
T/ 01727 869141
E/ stevesmith@mercerhole.co.uk



Caroline Stark

Senior Manager
T/ 01727 869141
E/ carolinestark@mercerhole.co.uk



Peter Godfrey-Evans

Partner
T/ 01908 605552
E/ petergodfrey-evans@mercerhole.co.uk



Paul Brindley

Senior Manager
T/ 01604 669330
E/ paulbrindley@mercerhole.co.uk



Chris Laughton

Partner
T/ 020 7353 1597
E/ chrislaughton@mercerhole.co.uk



Maurice Balfé

Manager
T/ 020 7353 1597
E/ mauricebalfé@mercerhole.co.uk

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