

# Corporate simplification projects

May 2012

## Corporate simplification

As companies continue their focus on cost efficiency and operational excellence, we have been helping some large corporate groups simplify their corporate structures. 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.

This complexity 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.

### Objective

The objective is to reduce the number of companies in a group. This is achieved by striking off surplus companies or (in more complex situations) liquidation.

### The benefits for you

The benefits are clear:

- fewer companies to manage and more time to focus on business issues;
- reduced complexity in the group structure should improve the group's risk rating with HM Revenue & Customs;
- lower compliance costs; and
- simplified reporting 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 and legal control sheets:** An overall plan for the simplification project is developed which splits the existing subsidiaries into groups ranging 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 each of those groups and this contains detailed steps for each company to take before it is eliminated.
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. *Progress Property Company Limited v Moorgarth Group Limited [2010] UKSC 55* demonstrates some of the complex issues which can arise even when market value is used. The Supreme Court stated that *"if a company sells to a shareholder at a low value assets which are difficult to value precisely, but which are potentially very valuable, the transaction may call for close scrutiny, and the company's financial position, and the actual motives and intentions of the directors, will be highly relevant. There may be questions to be asked as to whether the company was under financial pressure compelling it to sell at an inopportune time, as to what advice was taken, how the market was tested, and how the terms of the deal were negotiated. If the conclusion is that it was a genuine arm's length transaction then it will stand, even if it may, with hindsight, appear to have been a bad bargain. If it was an improper attempt to extract value by the pretence of an arm's length sale, it will be held unlawful. But either*

conclusion will depend on a realistic assessment of all the relevant facts, not simply a retrospective valuation exercise in isolation from all other inquiries.”

VAT: The VAT treatment of any business/asset transfer should also be considered.

If both companies are in the same VAT group then the transfer of assets will be disregarded for VAT purposes.

However the position is different if the business/assets are being transferred to another member of the group which is in a different VAT group. In that situation, if the transfer constitutes “the transfer of a business as a going concern” and meets the conditions set out in the VAT (Special Provisions) Order 1995, VAT is not chargeable.

If the transfer also involves land and buildings then additional requirements must be considered. Particular care must also be taken if only part of a business is being transferred.

If the transfer does not qualify as “the transfer of a business as a going concern” it will be subject to VAT.

6. **Simplify balance sheets:** Typically this will involve capital reductions (where the companies have significant issued share capital/share premium), the declaration of dividends and 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.

Under the Companies Act 2006 the period within which a company can be restored to the register is now six years.

Under section 1030(4) Companies Act 2006, an application to the court for restoration of a company to the register may not be made after the end of the 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. Section 1030(1) Companies Act 2006 states that an application to the court for restoration of a company to the register may be made at any time for the purpose of bringing proceedings against the company for damages for personal injury.

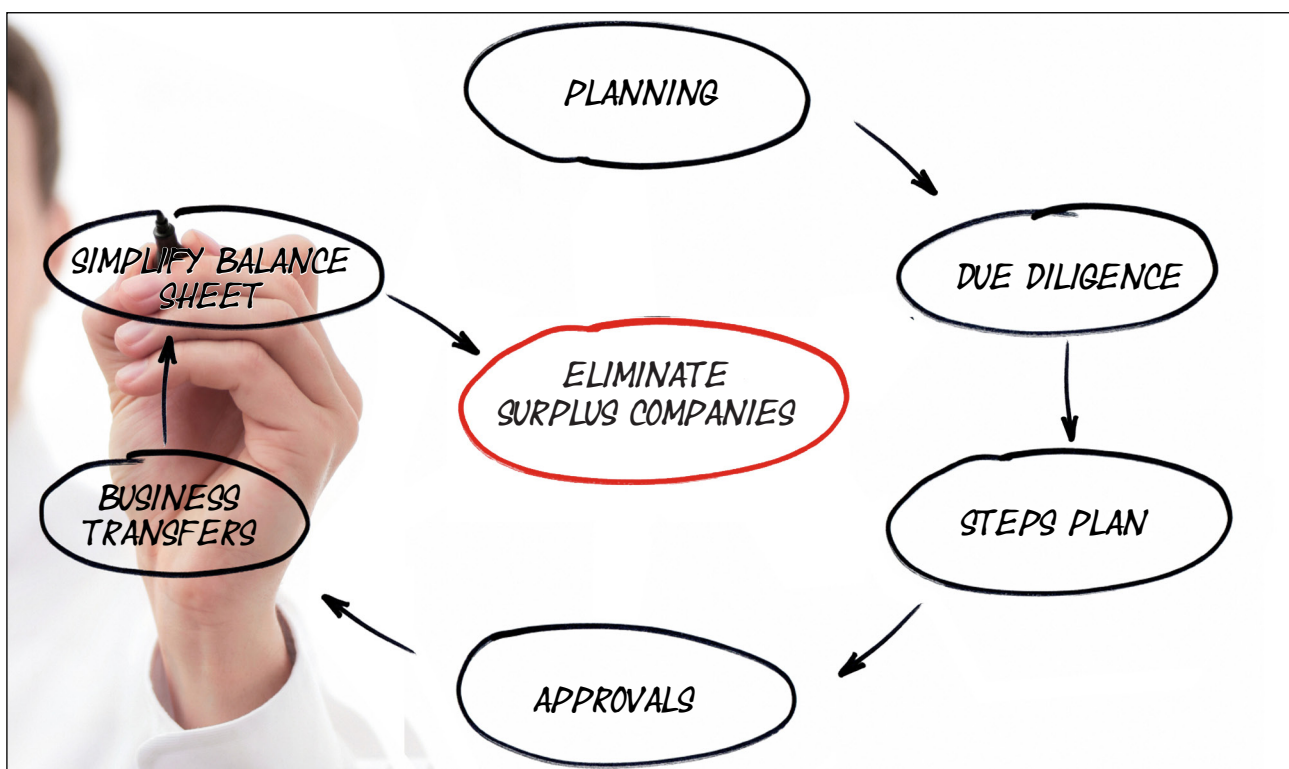
The previous regime which provided for 20 years (following a striking off) and two years (following the dissolution of a company) has not been carried over into the Companies Act 2006.

### 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 items 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.

Normally the simplified capital reduction process for private limited companies will be used to create distributable reserves. The Companies Act 2006 introduced a new procedure for private limited companies to enable them 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 to be treated as a realised profit. The relevant provisions of the Companies Act 2006 and the Order only refer to "share capital". However (subject to some limited exceptions) the provisions of the Companies Act 2006 relating to the reduction of a company's share capital apply to any share premium account, capital redemption reserve or redenomination reserve as if they were part of paid-up share capital.

Previous concerns about the tax treatment of dividends paid out of reserves created on a reduction of share capital have now been resolved.

**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 had been 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 has now been resolved by the introduction of section 845 Companies Act 2006. This provides 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 (TECH 02/10) contains some worked examples of a transfer of an asset applying section 845.

**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.

## Other key items to consider as part of the project include:

**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 (TECH 02/10).

If you would like any further information on simplifying your corporate structure then please speak to your usual contact at Burges Salmon or:



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