GROUP AND COMPANY REORGANISATIONS – S110 ARRANGEMENTS

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, Insolvency Act 1986. Provided the necessary criteria (e.g. not for the purposes of a sale or cessation of trade, not an investment business) are met, a statutory demerger can offer a relatively straightforward means of separating two trades. In our experience the criteria are such that most private business separations are made using the provisions of Section 110.

Here, we explain how a solvent liquidation and Section 110 allow 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 risk to other parts of the business, or to allow shareholders to take greater ownership of the part of the business they wish to develop. Again though an intention to sell in the short term is likely to be an issue so planning does need to be effected well in advance of any possible exit. 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, minimising the risk to a valuable asset of a downturn in trade and protecting the trading status of the operating company.

Company reorganisations are fraught with tax issues. These include Capital Gains Tax (CGT), income tax on (potential) distributions, transfers of value between shareholders 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.

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 shareholdings. 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 a new issue of shares in Newco A, or B to the shareholders of Newco H. The shareholdings in Newcos A, B etc. need not necessarily be in the same proportion as 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' interests within a company should not be frustrated by potential tax liabilities. HMRC recognise what can be achieved by 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 contact one of our Corporate Advisory partners.

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