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Corporate Simplification

Time for Action

Corporate Simplification
Agenda

Corporate Simplification

Speaker Introductions

Who are we?

Stephen Browne

Partner

Transaction & Restructuring Services

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Career Summary

- Partner and leads the Deloitte national corporate simplification team.
- 25 years experience in the re-organisation services arena and has spent over 14 years specialising in liquidations and assisting clients both in eliminating entities producing no economic value and exiting un-profitable businesses.
- Licensed Insolvency Practitioner as is licensed by the Institute of Chartered Accountants in England Wales to undertake liquidation appointment work.

Ian Dean

Director

Transaction & Restructuring Services

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Career Summary

- Ian has over 15 years experience specialising in solvent liquidations and reconstructions. He is a licensed Insolvency Practitioner who also has experience of a wide range of formal insolvency appointments.
- Ian's role is to assess, advise and implement corporate simplification programmes for UK and multinational clients. He works closely with senior management and other advisors to identify and develop corporate simplification strategies.
- Ian specialises in large corporate simplification programmes, particularly the project management aspects, to ensure benefits are maximised throughout the process.

Neil Withington

Manager

Transaction & Restructuring Services

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Career Summary

- Manager in the Corporate Simplification team with over 10 years experience in solvent liquidations and corporate simplification projects.
- Qualified accountant (ACCA).

Niall Clark

Senior Manager

Restructuring Services Tax

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Career Summary

- Senior Tax Manager specialising in M&A and Restructuring Services.
- Over 10 years experience of advising businesses on tax matters including 3 years experience in the M&A and Restructuring Services arena. This involved advising on a number of corporate simplification projects and insolvency appointments.

Corporate Simplification

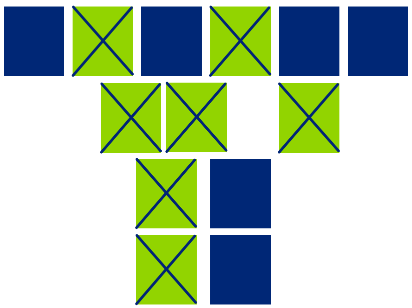
Overview

Key drivers
Operating companies
Routes to elimination
Project methodology

Corporate Simplification

Key Drivers

Entity Reduction

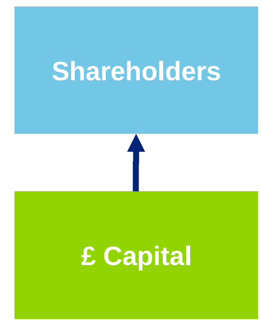


- Cost reduction:
  - Hold costs for dormant > £3,000
  - iXBRL – avoid need to file on-line with extendable business reporting language
  - Avoid any IFRS conversion issues
  - Reduce audit cost
- Simplifies inter-company transactions and mitigates transfer pricing issues
- Unlocks capital
- Reduces risk of corporate governance failures/breaches
- Prevents loss of legacy corporate memory
- Frees up time/regulatory burden

Managed Exit

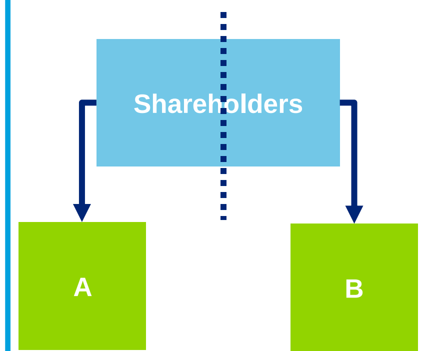
- Parent company wants to close its UK based business and eliminate legal entities

Return of Capital



- Economic purpose achieved/exhausted and surplus funds to be returned to shareholders
- Entity no longer required

s110 Demerger



- Reconstruction under the Insolvency Act to de-merge or partition a group of companies

De-merger	Division / Partition
• Target assets and business • Breaking out divisionalised trade • Splitting valuable property from a trading business	• Different shareholder objectives • Wealth protection – succession / inheritance / divorce planning

The "Corporate Simplification Jigsaw"

Considerations for operating companies

- Design of optimal structure, including maximising distribution capacity and 'flow' and avoiding risk of accounting exposures
- Entity statutory reporting requirements and IFRS

- Eliminate dormant companies
- Returning "locked in" capital

- Tax efficient business models
- Indirect tax issues
- Tax reporting
- Transfer pricing
- Tax transition issues

- Internal controls efficiency
- Compliance and regulation
- Governance and delegation of authority

- Operating model design
- Management model design
- Process design
- Systems & back office
- Management reporting
- Project management
- Management of change

- Organisation design
- Workforce transition
- Recruitment
- Communications
- Pensions

- Contracts
- Legal DD
- EU Merger process/legal transition
- HR legal

- Project manager(s)
- Reporting tools
- Detailed plans with key milestones

The Elimination Process – Methodology

Project Management

Phase 1
Pre-elimination review

Phase 2
Resolution of issues

Phase 3
Formal liquidation (or strike-off if assets < £4k)

DATE → **Job Plan**

DATE → **Day of Liquidation**

DATE → **Dissolution**

Objective

Identify those issues which need to be resolved prior to the elimination or as part of a liquidation process.

Objective

Resolution of those issues identified in Phase 1.

Pay as many claims as possible to avoid taking them into the liquidation (stat interest is currently 8%)

Objective

1. Realise the assets and/or distribute in specie

2.Seek out and settle any claims

3.Distribute residual value to shareholders.

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Routes to elimination compared

Members solvent liquidation

When?

- For companies that have traded
- Capital/assets > £4,000 (say)

What?

- Legal process that on completion stops time running for creditors and endorses what has gone before it (shout to the liquidator or forever hold your peace)

Why?

- Gives greater certainty and protection to directors
- Should an issue arise post liquidation former liquidators issue not directors
- No bona vacantia issues

Strike-off

When?

- For companies that have been dormant for a number of years (preferably 12) or have never traded
- Capital/assets < £ low (ESC 16)

What?

- Simple process that removes company from register – there must be no third party payables and no trading in last three months

Why?

- Quick and cheap option (when there is no risk) as directors will have to deal with issues up to 6 years post dissolution.
- Loss of asset (bona vacantia)

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Solvent liquidation – process overview

Balance sheet simplification
Declaration of solvency
Case study

Solvent liquidation legal process - overview

- Directors powers cease and liquidator becomes responsible
- Contracts can be automatically terminated
- Normal filing requirements cease
- All payables become claims that are no longer “payable” but “provable” for dividend purposes (8% stat interest)
- Statute of limitations no longer applies – so time keeps running for creditors until final dividend is paid and liquidation is closed
- Liquidator stops time running by giving notice to all potential creditors to claim
- If creditors fail to make a claim they cannot disturb dividends declared and paid by the liquidator, but can be paid subject funds being available
- If a known creditor is missed/not given notice the liquidator is personally liable to that creditor
- On completion of liquidation time stops running for creditors

Balance Sheet Simplification

From accounts to the Declaration of Solvency

	Notes	2010 £	2009 £
Current assets			
Debtors	6	10,874	131,850
Investments	7	241,151	139,566
Cash at bank and in hand		10,006	10,000
		262,031	281,416
Creditors: amounts falling due within one year	8	73,509	32,063
Total assets less current liabilities		188,522	249,353
Capital and reserves			
Called up share capital	9	100,000	100,000
Profit and loss account	10	88,522	149,353
Shareholders' funds		188,522	249,353

	Notes	2010 £	2009 £
Turnover	2	–	131,450
Other income	3	11,693	55,270
		11,693	186,720
Administrative expenses	4	72,524	8,663
(Loss)/profit on ordinary activities before taxation		(60,831)	178,057
Tax on (loss)/profit on ordinary activities	5	–	28,704
(Loss)/profit for the year	10	(60,831)	149,353

Form 4.70 contd

Statement as at «Dec_Sol_date»showing assets at estimated realisable values and liabilities expected to rank

Assets and Liabilities			Estimated to realise or to rank for payment to nearest £	
Assets:			£	
Balance at bank				
Cash in hand				
Marketable securities				
Bills receivable				
Trade debtors				
Loans and advances				100,000
Unpaid calls				
Stock in trade				
Work in progress				
Amount owed by parent undertaking				
Freehold property				
Leasehold property				
Plant and machinery				
Furniture, fittings, utensils etc				
Patents, trade marks etc				
Corporation Tax recoverable				
VAT recoverable				
Estimated realisable value of assets £				100,000
Liabilities:			£	
Secured on specific assets, viz.				
Secured by floating charge(s)				
Estimated cost of liquidation and other expenses including interest accruing until payment of debts in full				
Unsecured creditors (amounts estimated to rank for payment)	£	£		
Trade accounts				
Bills payable				
Accrued expenses				
Other liabilities				
Contingent liabilities				
Estimated surplus after paying debts in full		£		100,000

Remarks: The costs of the liquidation will be settled by an associated company.

A typical example

From accounts to the Declaration of Solvency

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Debtors

- Due from whom? Intragroup or external, collect or write off.
- Interest bearing debt? If yes, need to consider imputed interest or whether it can be made non interest bearing.
- P&L impact of write off and/or imputed interest.
- Can intragroup debtors be used to offset intragroup creditors to eliminate the creditor balance?

Investments

- Investment in subsidiary or 3rd party investment? Will it be sold or transferred pre liquidation? If yes, at what price and will consideration be cash or intragroup loan?
- Does the carrying value match the underlying value of the investment?
- Is an impairment review required?

Cash

- Can the cash be used to pay any creditors so the account can be closed?
- Is there bank security in place?

Creditors

- Due from whom? Intragroup or external and is it interest bearing?
- Can external creditors be paid pre-liquidation?
- Are additional accruals required, especially for tax?
- P&L impact if creditors or accruals released?

A typical example

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Steps:

- Obtain confirmation from trustees of former pension scheme that there is no longer any obligation or liability in respect of the subsidiary.
- Obtain release of security from charge holder (satisfaction of mortgage or charge).
- Transfer investments to another group company in lieu of non interest bearing loan.
- Write off third party debtors and reflect through the P&L.
- Reverse accruals included in other creditors with corresponding adjustments in P&L.
- Use cash to partially settle intragroup creditors and then close the bank account.
- Offset the remaining intragroup creditor against the remaining intragroup debtor balances.
- Ensure necessary tax position is up to date and make any necessary accrual.
- Declare final pre-liquidation dividend to extract the P&L reserve and avoid any potential Capital Gains Tax liability created by a liquidators' capital distribution.
- Produce final balance sheet and import information into the Declaration of Solvency.

Corporate Simplification

Topical issues

Onerous leases
Business rates

Onerous leases

Typical Scenario

- Client has unwanted leasehold premises
- It has offered a payment to the landlord to accept an early surrender but the landlord has refused

Potential solution

- Liquidator has power to disclaim a lease
- This determines the lease and triggers a claim by the landlord
- Claim must be mitigated re Park Air Services plc
- Net claim is often less than the anticipated surrender value

Criteria

- Company that holds the lease must be capable of being placed into liquidation e.g. not the main PLC trading co. Group guarantees are not necessarily "show stoppers" but AGAs terms can be more challenging
- Cash needs to be available to pay claim

Business rates and solvent liquidations

DANGER
EMPTY BUSINESS RATES

Concept

- Utilises current Rating Regulations
- Members' Voluntary Liquidation shelters empty property from business rates
- Business rates are not therefore payable by a liquidator unless they are using the property
- Company that owns the property must be capable of being placed into MVL

Savings

- Saves business rates for up to 2 years (could be more but spirit of MVL?)
- Savings must be compared to costs, including costs of transfer to a new owner if property required at end of MVL

Business rates – typical scenario

- Property must be empty
- Property must be in separate company or placed into an SPV
- Lease can be created and transferred to newco – newco can then be placed into MVL (keeping owner away from liquidation)
- Property company placed into liquidation
- Claim empty business rates exemption from date of liquidation.
- Property distributed “in specie” by liquidator at appropriate time to another group company
- Liquidation ends and company dissolved
- Max period – probably 2 years (spirit of MVLs)

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Points for in-house legal team

Business transfers

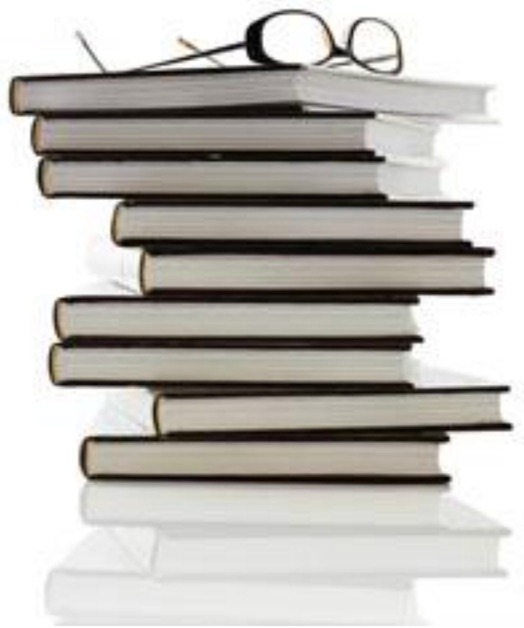
Indemnities

Bonding and engagement letters

Director powers and dealing with claims

Capital reduction

Debt waivers



Business transfers

So what happens to the business?

- Third party or intra-group?
- What to transfer, when and for how much?
- Net book value v market value - Aveling Barford and s845 (CA2006)
- Tax
- Warranties and indemnities
- Directors duties
- Post completion obligations
- Share transfers
- “Mop up” deeds and ring fencing
- Impact on the elimination process

Indemnities and liquidators

Why

- Liquidators are personally liable if they declare and pay distributions incorrectly. This is therefore deemed a high risk area

When

- Some liquidators will always insist on them, but do they actually need them?
- Company can often be made “unlimited” so not helpful to the indemnifier

Suggested approach

- Look at the individual circumstances – if an early distribution (within 21 days notice to creditors period) a liquidator will require an indemnity
- Otherwise the indemnity should be there to protect the directors (provide funds to pay a valid claim or provide a fighting fund to deal with a spurious claim)

Bonding and engagement letters

Bonding

- All liquidations are required to be bonded for gross assets - £5m maximum
- Be aware of the commercial considerations if you need a liquidator to distribute large amounts over £5m

Engagement letters

- Engagement letter is only for the pre-liquidation period
- Liquidation itself is governed by the Insolvency Act

Directors powers/claims management

Liquidators sanction of powers can be cost effective

- Directors powers cease on appointment of liquidators unless sanctioned
- If an “unknown unknown” claim arises, sanction of powers can be most cost effective way forward as in-house legal team often has the knowledge
- Key is to agree protocol/actions to manage process ASAP
- Bear in mind as all claims are now “provable” liquidator has to:
  - Pay distribution to creditor (100p in £ + stat interest on agreed claim)
  - Provide for claim (if contingent)
  - Reject claim (in full or in part)
- If claim is rejected creditor has 21 days to apply to Court to have that decision reversed or varied. Normal litigation rules apply if this happens
- Key is to negotiate/agree quickly amount of claim if valid

Capital reduction and corporate simplification

When to use it?

- Does not eliminate the company, but it can help with tax planning pre liquidation
- Can help speed up the movement of cash prior to liquidation rather than wait for liquidation
- Minimise the liquidators risk – very helpful in 2008 with bank liquidations where the shareholder was large creditor of Lehman. This would have made a “day one” distribution in the liquidation very high risk/not possible

Debt waivers

Areas to watch

- The nature of the loan relationship
- Connected or unconnected parties
- Loan waivers for insolvent companies
- Loan waivers for solvent companies
- Capital maintenance and CA2006
- Unlawful distributions
- Considerations for directors
- Impact for the counterparty
- Bona vacantia
- Tax implications

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Tax considerations

Key tax benefits

- Reduce future compliance costs and risks
  - Professional fees
  - iXBRL
  - Senior Accounting Officer
  - HMRC risk ratings
- Tax free distributions within a group pre liquidation
- Realise 'hidden' losses to shelter future gains

Key tax ‘pitfalls’ and points to note

- Care needed in simplifying intra group balances
- Avoid trapping value in a liquidation
- Avoid storing up cash tax charges when transferring properties or shares
- Preserve losses on transfers of trade
- End of an accounting period – tax returns needed

Corporate Simplification

Key messages and close

Key messages

- There are many benefits of having a simplified group these include: capital is unlocked, costs savings, reduces risk, reduced corporate memory loss
- Indemnities – does the liquidator really need one?
- Directors powers cease on liquidation – but do they have to?
- Tax planning is always essential
- Is the company offshore for tax purposes – if so appointing UK liquidator could bring it on-shore
- Debt waivers – the company waiving the debt needs the distributable reserves to do so
- Be careful with debt waivers, particularly if you have managed to persuade a third party to do so – tax implications
- Is strike-off or liquidation more appropriate? Liquidation is a legal process that stops time running on completion for everyone who had notice

Audience comparison

18,000 subsidiaries sit behind the top 200 UK companies

50% of these 18,000 are classified as dormant

Audience – 7,000 UK listed companies

2,900 of these are classified as dormant 41%