



Corporate Simplification Group

Value extraction and elimination options



Benefit of company eliminations

Simplifying a group structure may involve eliminating intragroup balances, transferring or extracting value, and dissolving redundant entities. Subject to tax considerations, potential benefits include:

Cost



- Reduces recurring compliance costs eg in-house accounts, audit, filing annual accounts, confirmation statement, group financial reporting obligations, ixbrl tagging costs, tax return and group wide tax reporting, company secretarial and document storage costs, pension compliance costs and triannual actuary reports
- May facilitate discussions for a reduction to the Group's overall audit fee
- Potential cost savings when seeking to re-finance or restructure ie a simpler structure typically requires significantly reduced due diligence, potentially saving professional advisory fees
- Once concluded, Base Erosion and Profit Shifting (BEPS) compliance costs may be reduced
- For large groups, country by country reporting and tax strategy reporting formalities may be reduced

Efficiencies



- Removal of dividend blocks
- Simplifies intercompany debt matrix, reducing interest burden and transfer pricing obligations
- Can release value upstream in group structures
- May accelerate crystallisation of capital losses
- Simplifies intragroup transactions and reduces the burden of reconciling and consolidating results
- Avoids extra work created by regulatory or legislative changes
- Use of a liquidator brings with it powers to deal with contingent claims

Risk



- May mitigate risk of HMRC enquiry and reduce HMRC risk rating
- Reduces risk of compliance and corporate governance breaches eg potential late filing penalties
- Prevents loss of corporate memory ie why an entity was inserted where it was, what it did and what contingencies may exist
- Use of a liquidator to set a deadline for claims can help a group de-risk

Governance



- Improves speed of decision making, making groups more agile and better able to react to market changes
- Improves transparency, enhancing investor perception and directors' reputation
- Improves attractiveness for funders
- Frees up senior management time to focus on business critical issues

Your choice of procedure



We summarise below the three procedures available to either extract value and / or eliminate entities. Tax advice should be sought in all cases. In all instances when seeking a corporate elimination, it is assumed there will be a period of dormancy during which a thorough assessment of the entity's affairs will be carried out and compliance obligations completed as far as possible.

Capital reduction under Companies Act 2006

Suitable for: Value extraction

- Available to solvent private companies (do not need to be dormant)
- Solvency statement to be signed by all directors
- Requires same due diligence and preparation as a Members' Voluntary Liquidation (MVL)
- Creates distributable reserves under statute (or direct repayment of capital)
- Applies to share capital, share premium and capital redemption reserve. Other types of locked-in capital may need to be capitalised or dealt with via MVL
- Can be used to extract value, by repaying capital in excess of company's requirements or to maximise distributable reserves
- Can be used to remove a dividend block by reducing or clearing debit balance on P&L reserve
- Leaves company in existence to trade on, remain dormant or be eliminated via MVL or strike off

Strike off under S1003 Companies Act 2006

Suitable for: Elimination

- Suitable for dormant companies and LLPs with minimal retained value and no legacy issues
- Cheaper process compared with MVL
- Requires same due diligence and preparation as MVL
- Not allowed if company has traded, disposed of stock or changed its name within the previous 3 months
- Directors/designated members retain responsibility and liability for all aspects of the entity's affairs throughout
- Creditors or other interested parties may object, delaying process
- Greater personal risk for directors/designated members and more onerous filing obligations, if subsequently restored to the Register

Members' Voluntary Liquidation (MVL)

Suitable for: Value extraction and elimination

- Suitable for companies and LLPs
- Formal process to close off directors'/designated members' responsibilities and statutory accounting and tax filing obligations
- Termination of Companies House filing obligations for annual accounts and confirmation statements
- Statutory declaration of solvency to be made by all or a majority of the directors/designated members
- Directors'/designated members' powers cease upon appointment
- Provides statutory advertising process for creditors
- 'One-stop' distribution and elimination process for an entity and its directors/designated members and members
- Positions a liquidator between any creditors and the entity's directors/member(s)
- Distributions from a MVL are capital in nature

The above is a summary. More detail is provided in the following pages to assist directors, designated members, members and other stakeholders consider the issues surrounding eliminations and aid their decision as to a preferred elimination option. We will help you assess the Target Companies and agree with you the procedure(s) to be adopted for each entity to best meet your objectives and risk appetite, recognising that MVL terminates a company's filing obligations with the Registrar of Companies.

When considering extracting value, if there are capital contribution reserves, and is it unclear whether they are to be treated as distributable, we can provide paperwork to capitalise such reserves and then conduct a capital reduction to create distributable reserves.

Elimination considerations and options

Why eliminate a company?

1. Reduces the costs of complexity by eliminating recurring compliance costs, accounting and audit fees, statutory returns and compliance information.
2. The Financial Reporting Council's UK Corporate Governance Code, revised in July 2018, places a greater emphasis on mitigating and reporting on risk within the statutory accounts, and engaging with shareholder groups and addressing their concerns. For groups, eliminating dormant, loss-making or non-core companies can remove dividend blocks and release reserves within the group, create more transparent group structures, encourage good corporate governance, enhance investor perceptions and save management time and professional fees, especially when seeking to re-finance or divest
3. For family businesses with no succession plans, a sale of business may generate greater returns for shareholders than simply winding down the trade, selling the assets and collecting the book debts. Eliminating the company can enable a more tax efficient manner of returning surplus funds to shareholders and provides greater peace of mind that distributions will not be challenged
4. Where a sale of a group is anticipated, elimination of surplus entities in advance of a sale process reduces a buyer's diligence requirements, possible warranties over historical matters and general deal friction, enhancing deal value for the vendor
5. Reduces work created by regulatory or legislative reforms
6. Simplifies intragroup transactions and work in consolidating and finalising results (including reconciling intragroup balances) and may mitigate transfer pricing exposure
7. Eliminate costs of conversion to IFRS, iXBRL etc
8. May reduce HMRC risk rating for the group
9. Minimises board and group risk by utilising the knowledge of current/recent directors and avoids loss of legacy corporate memory
10. Frees up senior management time to concentrate on strategy at both head office and divisional level



Elimination considerations and options (continued)

What does an MVL provide that a strike off application does not?

1. Formal termination of directors'/ designated members' (for Limited Liability Partnerships) powers and responsibilities (the liquidator winds up the entity's affairs)
2. Termination of Companies House filing obligations for annual accounts and annual confirmation statement
3. Termination of an accounting period for corporation tax purposes
4. Termination of VAT reporting period for individually registered entities. Group entities can be withdrawn from VAT group with no effect on remaining registration (assuming there are still 2 or more registered members)
5. A more structured finalisation of tax affairs as part of the liquidation process with HMRC issuing a formal proof of debt
6. Ability to plan and "fix" the date for items 1-4 above
7. Obligation on liquidator to seek out, agree and pay valid creditors' claims, using prescribed statutory advertising process, providing a specified period within which any creditors claims have to be "proved". Creditors claiming after that date cannot disturb previous distributions to creditors
8. Liquidator's powers to adjudicate on claims received, and reject in whole or in part
9. Liquidator's powers to adjudicate on contingent claims and, if appropriate, seek a Court order pursuant to s153 Insolvency Act 1986 setting a "cut off" date and seeking relief pursuant to s1157 Companies Act 2006
10. Provides greater "protection" for directors/ designated members and members in that any creditor who does not submit a claim in response to the statutory liquidation procedure is likely to have a more onerous task subsequently seeking to restore a company to the register to pursue a claim
11. Liquidator's powers to disclaim onerous assets or contracts
12. Legal process to provide a return of surplus assets as a return of capital under company and tax legislation (subject to targeted anti avoidance rules introduced 6 April 2016)
13. Where shareholders are individuals, amounts over £25,000 can be distributed to members as capital (subject to certain criteria being met), without need for a capital reduction process which would be required before a strike off
14. All types of capital can be distributed, unlike capital reduction process prior to strike off, that has limited scope to reduce certain reserves
15. Provides clarity/ transparency of how an entity's affairs have been wound up as set out in a liquidator's report filed at Companies House
16. Where the knowledge of a company is incomplete, and there may be unidentified assets such as contractual interests, investments, bank accounts etc, a liquidator can complete a "sweeper agreement" and assign all such interests to a shareholder
17. Upon closure, a fixed and truncated period for the retention of books and records, being 12 months following dissolution of the company (approximately 15 months after liquidation closed)
18. As a formal process involving a licenced insolvency practitioner, it costs more than striking off.

Elimination considerations and options (continued)

As the strike off procedure is cheaper, what are the risks or downsides of opting for this procedure?

1. The strike off process does not provide any formal protection for any class of stakeholder, such as directors, designated members, creditors and members. The risk of future unidentified issues is higher following a strike off than an MVL, as the entity has not been formally wound up and there is typically less due diligence undertaken pre strike off
2. In the absence of a formal advertising process, the onus is on the directors/ designated members to identify and notify all actual and contingent creditors of the strike off application (together with other prescribed parties). Failure to do so could result in personal liability and fines
3. Directors may hope the member(s)/group would settle any and all late claims, but that is not guaranteed, especially where a director may have left the group on unfavourable terms
4. Any creditor or "interested party" can lodge an objection to the striking off process with the Registrar of Companies at any time up to dissolution, delaying the strike off process for an uncertain period – can make it more difficult and time consuming
5. HMRC is often a party that lodges an objection, that process is managed in a MVL through HMRC issuing a proof of debt. In a strike off, HMRC's records showing outstanding returns could delay the striking off
6. If there are any external creditors, or connected group liabilities, there is a potential risk of these being taxable as an informal release, which could crystallise a tax liability
7. Risk for directors – 6 years during which the entity may be restored. If restored the directors/ designated members may be liable for completing all outstanding returns, filings and statutory accounts, together with potential late filing penalties and then have to deal with the entity. By contrast, if restoration occurs following an MVL, it is restored and shown as still being in liquidation, with no obligation to bring filings etc up to date
8. As part of the preparation for striking off, any and all assets should be identified and legally distributed/ transferred to avoid them reverting to the Crown upon dissolution under the bona vacantia rule (ownerless assets)
9. There is no transparency/public record of how the entity's affairs have been concluded subsequent to the information included in the last set of accounts filed at Companies House
10. If the members are individuals and net assets exceed £25,000, a capital reduction will be required before striking off. A capital reduction can only reduce share capital, share premium and capital redemption reserves, and specialist advice will need to be taken to deal with other capital reserves. If the members are corporate entities, a capital reduction is likely to be required for lower levels of capital
11. Best practice requires the directors/designated members to retain books and records for the full statutory retention period (c. 6 years)
12. The procedure cannot be pursued until the expiry of a 3 month dormancy period or for 3 months after a change of name.

Elimination considerations and options (continued)

What other considerations/ risks are there for directors/ designated members in deciding which procedure to adopt

1. To proceed with an MVL an entity must be solvent (can have zero net assets) to enable the required declaration of solvency to be made (if insolvent due to group liabilities it may be possible to release or re-capitalise the debt and return the entity to solvency)
2. Whilst it is possible under company law to apply to strike off an insolvent entity, if the insolvency is caused by intragroup indebtedness, it is recommended that tax advice is obtained regarding clearing intragroup debt prior to the strike off application
3. The placing of an entity into MVL is irreversible (without an application to Court), whereas an application to strike off can be withdrawn at any time prior to dissolution
4. It is an offence for a director/designated member to deliberately conceal a striking off application from an actual or contingent creditor, with risk of personal liability, fines and disqualification
5. It is an offence for a director/designated member to make a statutory declaration in an MVL without having made a full enquiry into the entity's affairs and formed an opinion as to its solvency
6. Profits arising on sale of assets after the date of liquidation cannot be off-set against trading losses made prior to liquidation
7. It is possible to protect directors/designated members in undertaking their role under either procedure through the use of indemnities from retained group companies and/or through directors' and officers' run-off insurance cover
8. Neither procedure involves the convening of any creditors' meeting, nor any investigation and reporting the prior conduct of the directors (as there is a presumption that all creditors have been or will be paid in full)

What happens if a claim or issue arises after the dissolution of the company

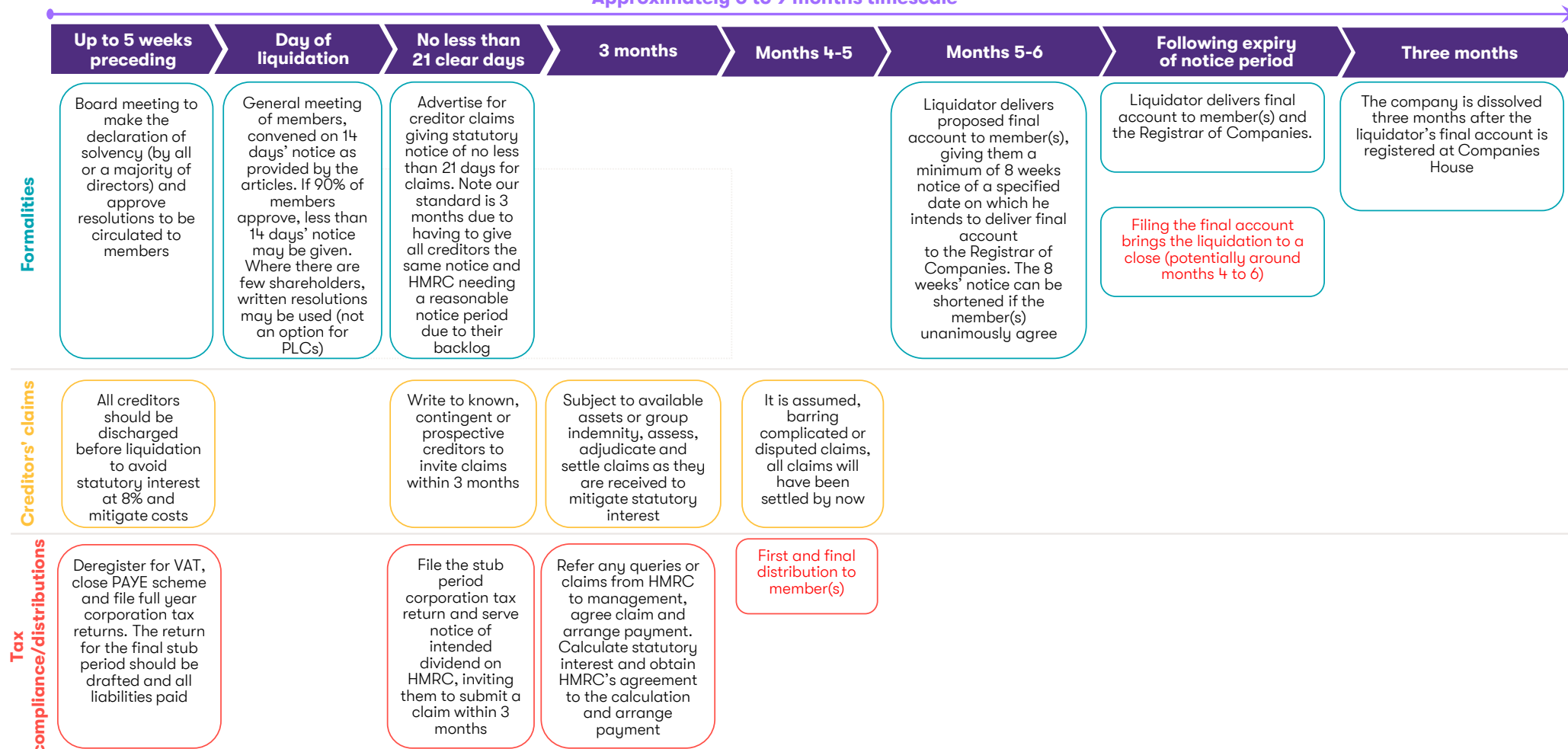
1. A creditor may seek restoration to pursue a claim any time in the ensuing 6 years after dissolution, whichever procedure was used. If restored following a strike off, the entity may be treated as if the dissolution never happened, and the directors'/designated members' obligations remain, including filing statutory returns such as annual confirmation statements, accounts and tax returns, with the risk of late filing penalties. By contrast, if restored following closure of a liquidation, the entity is restored, noted as still in liquidation and remains dormant with no filing obligations
2. A claim for personal injury may, however, be pursued at any time, without time limit. Under current law, a party may claim directly against the insurer pursuant to the Third Parties (Rights Against Insurers) Act 2010 without recourse to the company. The insurer has a right to request a dissolved company be restored, but unless there are potential antecedent transactions that could be challenged, it is unlikely an insurer would seek to restore a dissolved company.

Where can you find more information regarding applying for a strike off?

1. Guidance from Companies House can be found at <https://www.gov.uk/government/publications/striking-off-or-dissolving-a-limited-company/striking-off-or-dissolving-a-limited-company>
2. We would particularly draw your attention to the restrictions, notifiable parties at section 1.4 and potential offences at section 1.7.

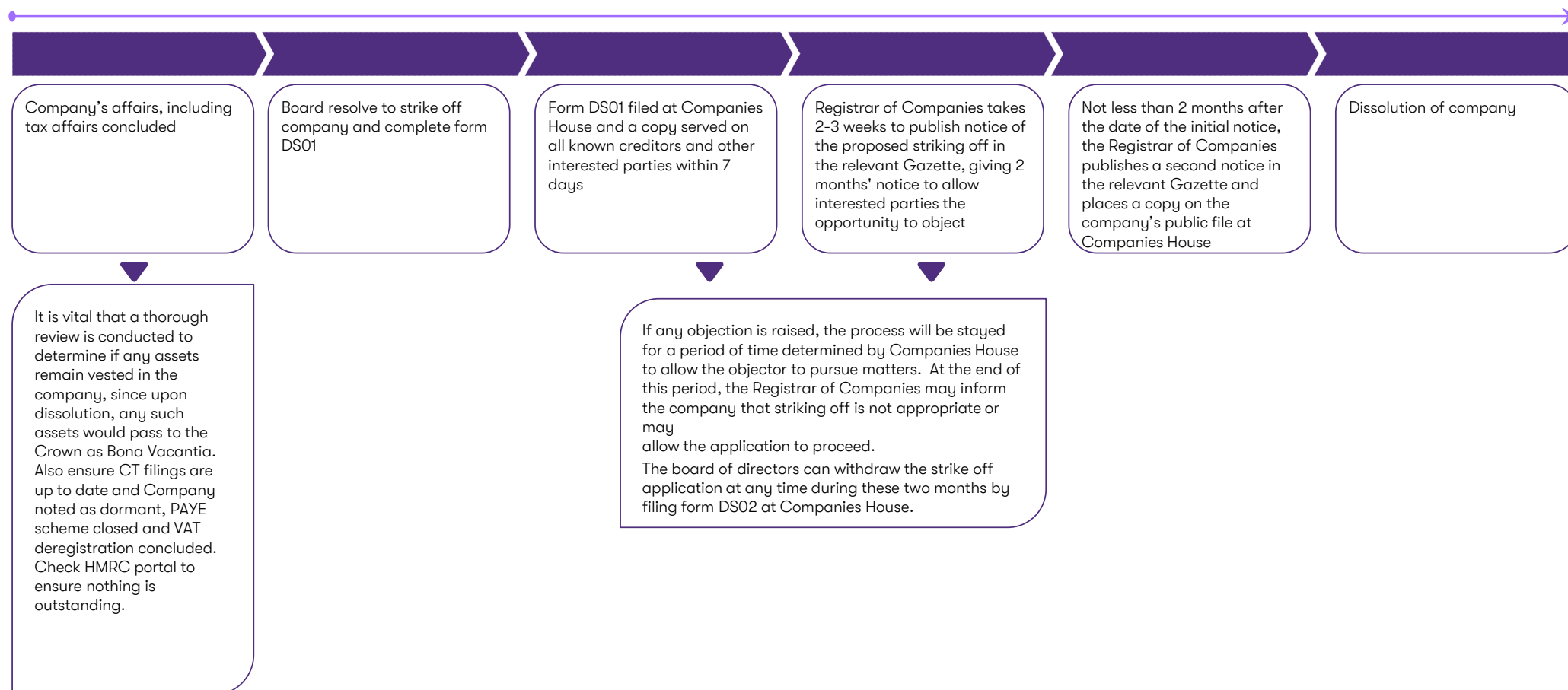
MVL process and indicative timeline

Approximately 6 to 9 months timescale



Striking off process and indicative timeline

Approximately 3 to 5 months



How we can assist

There is no point preparing a detailed step plan and completing legal documents to then realise there is a contingent liability that needs to be addressed. To assist management prepare a target company for elimination, before detailed work commences on assessing regulatory, accounting and tax matters and preparing steps to tidy the balance sheet, we can provide a pre-elimination questionnaire to assist management consider contingencies and practical loose ends. The extended version is useful for companies that have traded or which a group has recently acquired. Some clients pass the questionnaire to the management of a potential target for acquisition, to complement any due diligence being undertaken and facilitate a timely elimination after the purchase completes and the trade and assets are hived up.

We offer the following services:

- Searches of Pension Regulator databases
- Extended pre-elimination questionnaire
- Abridged pre-elimination questionnaire (suitable for dormant entities)
- Ad-hoc assistance
- Elimination control summary for extended group simplification projects
- Optional assistance regarding accounting and tax when preparing step plans to tidy the balance sheet in preparation for elimination.



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