ADOPTING A GROUP STRUCTURE
RING-FENCING YOUR ASSETS

Many successful businesses started off as a single limited company. In the early days they did not need to consider or plan for the complexities that can arise with a group structure. However, as a business grows the needs change, and it may be appropriate to consider the benefits of a group structure.

There are a number of legal reasons for thinking about a group of companies:

1. To ring-fence valuable assets to protect them against claim if the trading company is subject to litigation. The assets that are usually ring-fenced are property (the buildings from which the business operates), and intellectual property (such as the ownership of software, brand names, copyright or patents developed by the company).

   If these assets are left in the trading company, they are available to satisfy any claims made against the company. It makes sense, therefore, to consider holding them separately. One point to note, though, is that they need to be held above (i.e. in a holding company or another subsidiary of that holding company) or outside of the company (by one or more of the shareholders, perhaps), not in a subsidiary owned by that company.

2. To operate separate companies for different areas of the business of the company. This might arise if one part of a business is regulated and the regulation requirements would be too onerous if applied to the other businesses. It may occur because one of the businesses operates in a more risky environment.

3. To allow the operation of employee share schemes which are limited to the business in which the particular employees work, so that they reap the reward of their own efforts, not those of others.

4. If there is a plan to sell the business, in which case it may be convenient to be able to sell the shares of a limited company to avoid the need for some of the issues that can arise on a sale of assets.

If you do decide to adopt a holding company structure, you need to consider whether any parts of the existing company should be transferred up to the new holding company to enable them to be protected, as noted at 1 above.

The steps needed are reasonably simple, but should be carried out properly. Failure to effect the transfer in the right way will lead to two potentially major problems. Firstly, if there is a desire to sell the business, the purchaser’s solicitors will investigate the ownership and history. At the least, this will mean that you have to re-create the correct documentation at a later date. More seriously, it may be that the deal will not proceed. Secondly, if there was a claim against the business, the provisions of the Insolvency Act may mean that the assets transferred up to the holding company can be claimed back and will be used to settle any liabilities. The particular provisions that would apply are not time limited, unlike most insolvency rules, so could be used many years after the transfer took place.

Unfortunately, there can sometimes be an issue with tax. In order to protect the transfer from challenge it is important that any assets transferred up to the new
holding company, are transferred at market value. This is not book value, but a true market value at the date of transfer. Transfer at less than book value will mean that the transaction is challengeable, and, in addition, may mean that the directors of the company have personal liability for breach of the statutory duties that they owe to the company.

A summary of the steps needed, and the order in which they take place is set out below.

1. Obtain or incorporate a new company to become the new holding company.
   
   At this stage the subscriber share can be held by any one of the current shareholders initially, and can be left unpaid.

   All existing company officers could be appointed on day one.

2. An appropriate professional, normally your current accountants/auditors, should carry out a valuation of company for the purpose of the share for share swap which puts the new holding company in place.

3. Your accountant will make an application to HM Revenue and Customs for tax clearance for share for share swap. This application should not, also, the proposal to move any particular assets out of the company into the holding company or a new subsidiary of that holding company.

4. Prepare a share swap agreement recording the share swap and ancillary documentation, such as board resolutions, stock transfer forms.

5. Consider whether there is any stamp duty payable on the share transfer. It should be possible to take advantage of one of the statutory reliefs, but it does need to be checked. Even if using a statutory relief, the stock transfer forms on the share swap will need formal adjudication.

6. If there are to be additional subsidiary companies of the new holding company, they should be formed now. Ideally all subsidiary companies will adopt consistent articles of association.

7. If there are assets to be transferred from the existing company, whether to the new holding company or another subsidiary of that holding company, a short form asset sale agreement will be needed to record the sale and the market price. Often the sale price will be left outstanding on loan, and repaid out of dividends paid as the business develops. It is important, though, as noted earlier, that the sale is at market value.

8. Formalise the basis on which the old company uses the assets which it has transferred. In the case of property, a formal lease. If it is intellectual property, a licence agreement will be needed recording the royalties and any other relevant terms.