

Restructuring & Insolvency

SECTION 110 RECONSTRUCTIONS



Section 110 of the Insolvency Act 1986 allows the liquidator in a members' voluntary liquidation to transfer a company's assets to another company or companies in exchange for shares in the transferee company. This provision is commonly used to demerge or partition solvent businesses in a tax efficient manner.

When undertaking a demerger, the liquidator will typically transfer part of the business or assets to one new company and part of the business or assets to a second new company in consideration of the issue of shares in the new companies to the existing shareholders in their original proportions.

A partition typically involves the same process but, assuming two shareholders, shares in the first new company will be issued to the first shareholder and the shares in the second new company will be issued to the second shareholder, resulting in the two parts of the separated business being held by different shareholders.

Under sections 136 and 139 of the Taxation of Chargeable Gains Act 1992, a section 110 reconstruction should be tax neutral for the company and its shareholders.

PURPOSE

Section 110 reconstructions are typically used in the following scenarios:

- preparing for a sale of part of the business (demerger);
- separating valuable property assets from a trading business (demerger);
- separating new risky trades from the core business (demerger);
- facilitating the sale and leaseback of commercial property (demerger);
- facilitating different shareholder objectives (partition);
- resolving disputes between shareholders (partition);
- succession/divorce planning (partition);
- close ended fund reconstructions (partition).

KEY CONSIDERATIONS

As a section 110 reconstruction must be implemented through a members' voluntary liquidation, a Licensed Insolvency Practitioner is required to act as liquidator and directors will be required to make a statutory declaration of solvency. Shareholders will also be required to pass a special resolution to place the company into liquidation which will require a majority (75%) of shareholders to vote in favour.

The liquidation process requires creditors to be paid, released or novated. Accordingly, it is common for part

of the business to be transferred by way of dividend in specie to a new holding company which will be liquidated instead of the main trading company.

Shareholders will be required to indemnify the liquidators and solicitors will be required to draft transfer agreements and other ancillary documents. These include agency agreements, Land Registry documents or stock transfer forms, as well as incorporating any new companies. It will also be necessary to deal with lenders where assets which are subject to charges are to be transferred.

Shareholders may dissent from the scheme of reconstruction and, if creditors are not paid, then the scheme could be invalid and the original position restored. Directors would also be guilty of an offence for making a declaration of solvency without reasonable grounds for believing it to be true in the event of insolvency.

BENEFITS

A section 110 reconstruction is more flexible and cost effective than a statutory demerger and can be used to deal with investments and property and in preparation for a sale. Other benefits include:

- a section 110 reconstruction can be used to demerge an investment business;
- it is tax efficient and advance tax clearance can be obtained for the scheme;
- creditors' interests are protected and the robust process is managed by an experienced Insolvency Practitioner;
- provisions exist to deal with dissenting shareholders.

RISKS

Directors must undertake due diligence to ensure the company is solvent and the process cannot be used to avoid creditors' claims. Other risks include:

- Stamp Duty Land Tax (SDLT) relief will not be available for a partition;
- if it is not possible to liquidate a new holding company then the transfer of a complex trade may be a significant challenge and issues such as employees, pensions, guarantees, warranties, leases and charges must be considered;
- tax clearance will only be granted if the scheme is undertaken for a bona fide commercial reason and not principally to avoid tax and the scheme must be implemented in accordance with the tax clearance or the tax reliefs will not be available;

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