THE BENEFITS AND DRAWBACKS OF HOLDING COMPANIES

Business owners are always looking for ways to both protect their business' assets and maximise tax incentives. One of the most effective methods remains the separation of trade/investments into a separate or separate entities owned and controlled by a single holding company. This factsheet details the main issues to be aware of when undertaking this time-tested strategy to mitigate risk.

WHAT IS A HOLDING COMPANY?

A holding company is a separate parent company created to own a controlling interest in a subsidiary company or companies. They are private limited companies with their own shares and are usually non-trading.

ADVANTAGES

- Minimise the risk/asset protection
  - Allows for better asset management and better distribution and sales of assets. Key assets such as property, cash or trademarks can be transferred into a holding company to protect them from the higher-risk trading entity. The idea is that the main ownership of assets and rights sits in the non-trading holding company.
  - With multiple subsidiary structures, different corporate entities could hold separate key assets and thereby provide additional risk management benefits should any one of the other group companies be subject to legal proceedings.
  - The structure also helps with loans and borrowings as different lenders can be approached for each corporate entity.
  - The holding company should be protected from legal proceedings against it for any losses, debts or legal failings of operating subsidiary companies.
- Group relief
  - Provided the conditions are met (mainly 75% direct ownership), there are options to offset trading and other losses between the companies to allow for tax relief to obtained in a profit-making company should a loss be made in another.
  - A group structure can also allow for tax neutral transfers of assets to shelter any capital gains arising on transfer of chargeable assets between group companies.
- Substantial shareholding exemption (SSE)
  - Provided the conditions are met, the whole gain on disposal of shares of the subsidiary companies will be exempt. Consideration will need to be given to the subsequent extraction of the proceeds potentially, but if reinvested in new assets, then there shouldn't be any issues.

- Succession planning
  - Ensures business continuation, even if the trading subsidiary should fail as key assets are still retained.
- Dividend management
  - Any dividends paid by subsidiary companies to holding companies are exempt from Corporation Tax. The ultimate shareholder(s) can then extract the dividend from a centralised holding company rather than extracting from perhaps multiple different trading companies and so simplify profit extraction and tax planning.

DRAWBACKS

- Complex administration
  - Each subsidiary must produce their own accounts and keep their own business records separately which can create complexity and additional record-keeping costs
  - Intercompany balances (trading debts and straightforward loans) need monitoring and reconciling frequently.
- Management challenges
  - With multiple trading subsidiaries, the holding company typically influences the operating companies' polices and management decisions. This could potentially lead to conflict with subsidiary management structures.
  - Corporation Tax instalment payments
  - Depending on the total taxable profits arising in the company, the additional company can impact on the thresholds at which Corporation Tax instalment payments are required.
- Professional fees
  - Additional compliance fees as a result of multiple companies being involved (i.e. filings with Companies House, HMRC, etc.)

HOW TO CREATE A HOLDING COMPANY

- The creation of a holding company is relatively straightforward and is typically created through a "share for share exchange" which avoids there being any chargeable disposal of the existing shares by the shareholders for Capital Gains Tax (CGT) purposes.
- A "share for share exchange" is where existing shareholders exchange their shareholdings in the current trading company for an issue of shares in the new holding company. This effectively inserts a holding company between the current shareholders and the subsidiary company.
- A clearance request letter to HMRC Clearance and Counteraction Team is advisable to ensure the process does not trigger any CGT liabilities. The letter should outline the commercial rationale behind the proposal.
- With a share for share exchange, ownership proportions need to remain the same before and after the exchange.

The Inheritance Tax (IHT) position for the shares owned by individual shareholders should always be considered before undertaking any form of corporate reorganisation.

If you would like to know more about the information in this factsheet, please contact your usual Moore advisor.

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