ACCOUNTANCY | FINANCE | BUSINESS

# SMART STRUCTURING

## Laying the foundations to support your ambitions

MENZIES
BRIGHTER THINKING

# FOREWORD

## As your company grows so can its complexity. Whatever your ambitions, it makes sound sense to take stock of your business structure and risk profile, ensuring that it is optimally positioned to support your aims.

All too often, owners and directors disregard the importance of adapting their business structure, yet the process should be considered regularly as a board level matter. Smart structuring allows you to align your structure to your strategy, enabling you to seize opportunities as they arise, while protecting and enhancing your core business. With operating environments in constant flux, smart structuring is also imperative in helping your company to pre-empt and react to external change.

## By proactively managing your business structure and tax position you can:

1. Create a smart platform for growth.
2. Expand internationally with confidence.
3. Minimise risks.
4. Incentivise and reward employees.
5. Plan optimally for exit or investment.

# 1 CREATE A SMART PLATFORM FOR GROWTH

**As your business grows, the organisation can become complex both from a shareholder and corporate entity perspective.**

By smart structuring, you can achieve:

## Focused growth

If you are considering expanding a new venture, entering a new market or launching a new product, ring-fencing the venture into a subsidiary allows you or your management team to focus specifically on its growth prospects. It can act as a vehicle to attract investment or claim R&D tax relief if its focus is innovation led. It also helps to protect other group companies if the new venture is not successful.

## Integration

Structuring is an ongoing process, and what was previously fit for purpose may no longer be appropriate. Acquired assets or companies can be transferred to other group companies or a holding company to streamline the business and create economies of scale. The process of rationalisation can also remove unnecessary layers of management and administration, and enhanced integration can unlock hidden value.

## Efficiency and reducing costs

Not all parts of the business will achieve the same levels of profitability. Restructuring different lines of business into separate companies can be beneficial to provide you with better visibility across divisions. It also gives you the ability to channel resources effectively. Separating business units into discreet companies can provide the flexibility to sell or wind down non-performing parts of the business, allowing you to focus resources on growth. This can also be advantageous from a tax perspective.

## A common goal

As a business grows, shareholders may have different plans and priorities for the future. If there are disagreements about the direction of the business, shareholder buybacks or management buyouts can break the deadlock. Business interests can also be separated between different groups of shareholders, allowing each to pursue their particular interests.

You may want to incentivise new management executives by granting share options or create accountability by appointing company directors to specific subsidiaries that have clear goals and remits.

LUCY MANGAN
BUSINESS TAX PARTNER

*“Often a company outgrows the benefits of its original structure. A core part of our advice to clients includes structuring mature businesses to optimise processes and reduce costs. For example, consolidating businesses into a group structure can allow you to move profits around tax-efficiently within a group. Losses can also be more flexibly shared between companies, and certain assets can be more easily transferred around a group tax-free.”*

# 2 EXPAND INTERNATIONALLY WITH CONFIDENCE

**Having a cohesive structure in place enables a business to expand internationally with confidence by knowing how to deploy its funds, where it will make its profits, and how its cash will be returned home.**

As international trade grows and becomes more important to the success of the business, companies often take the route of putting boots on the ground in overseas markets. This physical presence is likely to change the dynamics from a tax perspective, with enhanced taxing rights arising in the local jurisdiction. Smart structuring will react to this by actively considering these tax implications and selecting the most suitable cross-border trading arrangements.

Where the arrangements are short term in nature and designed to test the water, companies may prefer to use a branch structure, especially if losses are likely to arise initially. However, smart structuring will often dictate that, from a commercial and risk perspective, as well as providing greater tax certainty, a subsidiary entity is set up to trade in the local market. In this respect, entity selection will be crucial, for example the use of a limited liability company or corporation in the US could lead to very different tax outcomes. Alternatively, it may be that organic expansion is not the right answer, and that a licensing, joint venture or acquisition strategy is the better approach.

International expansion is not a one-size-fits-all process, there are many options, and smart structuring is required to understand the various tax implications and find a route that works for you. For instance, the UK has an exemption system for inbound dividends, but this is size dependent, with different rules for small and non-small groups which can affect the tax cost on repatriation of profits from overseas jurisdictions.

*“When planning your next step internationally, the legal and tax rules in each country should be taken into account. Local advice should be sought and coordinated with your existing structure, including working through cashflow and profit implications to understand how cash will flow around the structure and how tax rules such as transfer pricing will apply in different markets.”*

NICK FARMER
INTERNATIONAL TAX PARTNER

# 3 MINIMISE RISKS

A key reason to review your business structure should be to remain tax compliant and ring-fence risk. A benefit of forming a holding company includes the ability to create a structure which separates assets from or between subsidiaries. This can have tax benefits, as well as limiting the risks to the wider business should a subsidiary incur certain liabilities or become bankrupt. In some cases, completely separating businesses into different group structures can be preferable, to provide better visibility over performance, more flexibility for divestment, engage with specific groups of stakeholders, and to access certain tax reliefs.

As your company diversifies, ensure that the business remains on the right side of the line with regards to tax. The very incentives and reliefs that have helped your business flourish could be at risk as the company's activities expand. The balance between investment and trading activities should be given particular attention, as should the ownership of subsidiaries.

Specific areas to assess include:

## Property

Smart structuring options with regards to property can include holding assets in a group company. Property can then be leased to other subsidiaries which can claim corporation tax reductions on rental payments. The property assets themselves are protected from liabilities that could be incurred by other subsidiaries. As working from home has become the norm since the pandemic, many companies have begun letting all or part of their properties to generate income. Companies should be mindful of how this affects certain reliefs. For example, if more than 50% of the company's activity is related to non-trading activities (property letting) rather than trading, Business Relief claims for inheritance tax purposes could be at risk.

Property investment activities can also affect eligibility for other reliefs, including Business Asset Disposal Relief, the Enterprise Investment Scheme and certain share incentive schemes. It is important to consider the impact of holding property assets in different ways to preserve and optimise these key capital gains tax and inheritance tax reliefs, and in some cases, it can be tax efficient to hold property assets in a separate group structure to operating activities.

## Intellectual property

Over the years, companies can develop or acquire valuable intellectual property (IP). It can be a sound move to ring-fence these assets into their own holding company which then grants IP licences to other parts of the group. This can protect a reliable income stream or allow you to sell the portfolio to generate cash.

## Business Asset Disposal Relief

Guidance around Business Asset Disposal relief (BADR) is nuanced. The relevant company must be classified as a trading company, which means that it cannot engage in substantial non-trading or investment activity. HMRC previously considered substantial to mean 20%, however recent case law has made the interpretation of the rule less straightforward. You should evaluate your businesses activities to ensure that the claimant company continues to qualify.

> *"We can work with you to evaluate the relative risks and rewards from restructuring with regards to IP. Factors include qualifying for the patent box scheme, which requires allocation to the claimant company and accurate tracking and tracing of R&D expenditure for several years."*

**ANTHONY LALSING**
**R&D TAX PARTNER**

## Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) was specifically designed to help smaller trading companies raise finance and grow and provides valuable tax incentives for investors. The main scheme can provide income tax relief worth 30% of the investment, as well as a capital gains free exit if the investment results in an eventual profit. There is also a seed scheme for really early-stage companies in which the income tax relief raises to 50%.

Companies are subject to a number of requirements at the time of the share issue and generally for the following three years. The rules are complex and applied prescriptively by HMRC. Typically, we would recommend obtaining an advance clearance from HMRC to provide assurance to potential investors that the qualifying conditions for the scheme are met. As your company grows or share structures change, you should monitor the qualifying conditions to protect shareholders from losing their tax relief and exemptions.

## Research & Development tax relief

HMRC are increasing their enquiry activity around Research & Development (R&D) claims. Be aware that *the rules changed* as of 1 April 2024, with R&D being required to take place in the UK in order to claim relief. Companies should review the impact of any loss of enhanced relief on offshore costs to determine whether to change the company's operational model and locate R&D activities within the UK. Subcontractor contracts should also be reviewed to ensure that their activities are in line with the new requirements.

# 4 INCENTIVISE AND REWARD EMPLOYEES

Smart structuring shareholdings can incentivise your teams and protect the overall business. Business divisions can be separated into their own companies with management teams incentivised via shareholdings or dividends based on their division's performance. Other triggers include a new CEO or senior executive who may want to negotiate a different remuneration structure; or you may want to pass on all or part of the business to employees.

## Enterprise Management Incentive Schemes (EMIs)

An Enterprise Management Incentive (EMI) share option scheme is a popular arrangement for incentivisation. Options can be structured so that they vest or can be exercised at different times, such as relating to length of service or meeting of performance objectives.

Eligibility for the EMI scheme is dependent on certain criteria, and it is important that your company keeps abreast of whether it remains eligible. These include:

- The company has fewer than 250 full-time employees.
- The company must remain independent.
- The company carries on a qualifying trade on a commercial basis.
- Property development and land ownership are disqualified from the scheme.

> *"We can advise on the best options to incentivise staff. If an EMI scheme is not possible, company share option plans or partly-paid shares could provide an alternative. You should also be mindful that the notification deadline for EMI share options has recently changed. Please see our note for more information."*

RICHARD GODMON
BUSINESS TAX PARTNER

## Management buyout

A management buyout can be an attractive strategy to allow for a specific group of aspiring employees to take ownership of a business.

The former shareholders can sell their shares in a relatively tax efficient exit manner, whilst transitioning ownership to a group of individuals who have a close understanding of the business, its culture and history. Those specific individuals can be incentivised by a greater sense of ownership and responsibility, as well as the prospect of financial reward in terms of future income and capital growth.

Typically, an acquisition will be structured through a new holding company, to manage risk for the various parties and provide flexibility to finance the purchase price.

## Employee Ownership Trusts

Employee Ownership Trusts (EOTs) are an alternative means to transition company ownership to employees. Benefits include entrenching a culture of staff engagement and protecting the legacy of the business. Employees can also benefit from up to £3,600 in tax free bonuses each year.

For business owners, EOTs can provide a path to exit that can be less stressful and quicker than a trade sale. Provided certain conditions are met, there should be no capital gains, inheritance or income tax exposures for outgoing shareholders when selling shares to an EOT.

The financial profile of selling shares to an EOT is, however, different from a trade sale, because the purchase price is generally paid for out of the future profits of the business. The financial feasibility of selling shares to an EOT therefore needs careful consideration to ensure that the timetable for repayment is acceptable to the shareholders as well as affordable for the business.

After establishing an EOT, it is important to ensure that there are suitable management and governance structures in place. EOTs must exist for the benefit of all employees on largely equal terms, so supplemental strategies may need to be adopted to target specific groups of employees who are particularly important to the business.

# 5 PLAN OPTIMALLY FOR EXIT OR INVESTMENT

A clear and coherent business structure is as vital to bolster investor confidence as a well-executed business plan. Conversely, complex group structures can reduce transparency across the business and create unnecessary risk that could deter their buy-in.

All too often, business owners engage their advisors at the point at which they wish to sell or attract substantial investment. To attract the most interest, the best valuation and to optimise a structure for sale, you should begin planning two to three years in advance to ensure that there are no skeletons in the closet.

> *"A risk review before going to market is important because it allows the company to get its house in order. It also flags up areas that buyer due diligence will pick up on, so that solutions can be considered in advance, or actions taken. We often identify the incorrect use of Personal Service Companies as a risk. You should also make sure that employment and consultancy contracts are properly drafted and in place. Please see our note for more information."*

RICHARD GODMON
BUSINESS TAX PARTNER

## Preparing to sell?

**Before you engage interest to sell, you should consider all your alternatives. For example, relevant factors might include whether:**

**To retain an interest in all or part of the business.**

**To use proceeds from the sale to fund a new venture.**

**To pass on the business to employees. An employee share plan, a management buyout or an Employee Ownership Trust (EOT) could be suitable.**

**To pass on the business to family members. This requires careful tax planning. For example, passing a trading company to a family member can benefit from 100% inheritance tax relief, whereas investment assets are not afforded the same treatment.**

## What buyers and backers will look for

Potential buyers or investors will undertake due diligence on the group. To achieve the best deal, you should:

- Ensure financial reporting visibility across divisions. For example, if your company undertakes a number of trades, you could separate each trade into its own subsidiary. This allows potential investors to understand the value of assets and the profitability of each division.
- Consider selling, partitioning, or demerging poor performing assets or activities before positioning to sell the business. This can also be beneficial to optimise your tax position, depending on the composition of the company and the strategy and envisaged timetable for divesting of or retaining different business units or assets.
- Maintain a clean compliance position. Ensure that your company is the right side of the line with regards to claiming certain reliefs. Also check that tax and financial records are kept up to date.
- Create a clear ownership structure. For example, consider buying back minority shareholders well before the point of sale, as buyers are highly likely to want to acquire 100% ownership.
- Retain key staff. You may need to reorganise shares to retain your management team and key shareholders and ensure the longevity of the business after sale.

PETER MILLS
BUSINESS TAX DIRECTOR

*“Large scale restructuring should not be undertaken at the 11th hour, and your business processes and structure should be as clean as possible to attract the right buyer at the best possible price.*

*Tax due diligence is paramount if you are considering selling your business. All too often we have discovered skeletons in the closet at the point a company is looking to sell. You should talk to your advisors at the earliest possibility to minimise any risks to your company’s valuation and tax position.”*

# HOW WE CAN HELP

Your business structure will need to adapt as your corporate strategy develops. Menzies are committed to client service, providing you with one point of contact backed by a team of specialists with expertise tailored to your needs. We work with you to ensure that your business structure, assets and activities are placed optimally to take advantage of opportunities and efficiencies.

## We help you devise the best route to achieve your goals, and can:

- Review your business operating structure to ensure that it remains tax effective and aligned with your commercial and personal objectives.
- Design restructuring processes and plan steps to minimise tax costs and maximise tax efficiencies.
- Planning for exits, mergers, partitions and demergers, as well as pre and post-sale restructuring, business valuations and capital structures. To maximise your tax advantage, you may need a Members' Voluntary Liquidation (MVL), for which our Business Recovery team can assist.
- Assist with communicating restructuring objectives and process to key stakeholders, including financiers, investors and employees.
- Coordinate with HMRC to obtain any relevant clearances and deal with reporting, disclosures, elections or relief claims.
- Our dedicated Deal Advisory team can advise on mergers and acquisitions, business disposals, management buyouts, fundraising efforts, and transaction support including due diligence services.

## Our international tax services include:

- Set-up of foreign operations, including subsidiary or branch structures.
- Transfer pricing reviews to support intercompany transactions.
- Cross-border funding arrangements, cash and profit management.
- Advising on local tax exposures arising from permanent establishments or withholding taxes.
- VAT and custom duty implications of cross-border services and movement of goods.

## Get in touch with our team to start your smart structuring journey today!

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