

A Closer Look at Legal Entity Rationalisation

A&M Tax Advisor Update (UK)

Field	Value
Creation Date	11/07/2012 - 02:39
Last Change Date	11/17/2014 - 09:58
Issue / Subtitle	Apr-12
Newsletter Date	04/25/2012
Status	Unpublished

"We tend to meet any new situation in life by reorganising. And what a wonderful method it can be, for creating the illusion of progress, while producing confusion, inefficiency and demoralisation." Petronius (27-66 A.D.)

Basic housekeeping to unlock cash savings is always on the corporate agenda and has been amplified in recent years by economic challenges. One method that has proven to be successful is legal entity rationalisation (LER) - the process applied by multinational entities to overhaul the group structure with the use of companies, sub-groups and branches to provide the most efficient structure.

Due to our restructuring heritage, Alvarez & Marsal is frequently involved in the rationalisation of complex corporate structures, but even a healthy group should consider reducing the number of companies in place. The end result can lead to cost savings, a simpler legal entity structure, reduced risk and more time to pursue value-added business initiatives.

Companies that have undertaken a LER exercise have already achieved the following benefits:

- *Corporate Governance*
Effective way to reduce internal and external compliance costs and time commitment, simplify the group structure, and remove unnecessary entities.
- *Risk Reduction*
Improve overall risk profile of the group in relation to financial operations, and tax risks, arising out of mismatched historic intra group balances, with impact on veracity of audited accounts.
- *Free-Up Distributable Reserves*
The ability to provide for cash settlement of receivables with perhaps "in doubt" group counterparties, permits distribution of previously 'trapped' reserves.
- *Optimisation*
If the group is planning an entity reduction exercise then the process can be commercially driven (e.g., divisionalise separate companies), and may also permit optimisation of the group's tax position.

Conversely, many organisations have cited the following reasons for not undertaking a LER exercise:

- *Competing demands on time*
"Oh Lord, make me virtuous, but not just yet." St. Augustine
The process can be time consuming and will require the allocation of management time and / or professional fees.
- *The structure is already as efficient as possible*
Many groups have already undertaken this exercise as part of the risk assessment and controls process.
- *Property requirements and restrictions name and intellectual property preservation*
It is important to include legal teams as part of this exercise to increase the benefits of rationalisation.
- *Concern over the tax implications*
Taxation will need to be reviewed and managed - however, the benefits are likely to outweigh any tax costs. There may also be benefits in releasing trapped losses / reliefs as part of the commercial rationalisation.

THE PROCESS

Should such an exercise be of interest, here are the steps to follow:

Analyse

The key points include:

- Map current structure
- Identify the numbers of companies required, primary hurdles to enacting change and estimated benefits: financial / organisational / commercial
- Annual savings in excess of £30K per company is common.

Execute

An anonymised example of a successful LER follows to demonstrate areas that may resonate with readers:

An Implementation Example: Simplification

Cost savings over £500K. Key benefits included:

- Group statutory account preparation process dramatically simplified and efficiency increased (accounts now completed and filed within five months of year end as opposed to previous 10 months)
- Cost reductions across HR, Company Secretarial and Group Finance due to simplified entity structure
- Cost reduction in audit and other external supplier (typically legal, tax, filing) fees as number of active entities reduced
- Simplified pension arrangements due to reduction of scheme employers, reduced compliance admin and refocus of pensions department
- Rationalised property occupancy and ownership reflecting group reality
- Group operational risk profile reduced (employees in known entities with standardised contracts, property portfolio known and properly insured, external contracts in correct companies, Intellectual Property in known entities)
- Reduced risk profile with HMRC -- welcomed simplification of structure, the reduced compliance review burden and fact they were involved in process

Six Practical Implementation Tips

1. At inception and early stage:

- External / internal shock can focus attention on need for improvement. Accounts restatement, merger synergies
- CFO / board sponsor / legal
- Project manager and point-man, full time
- Wider team, part time
- Appoint directors, needed to sign off expiring subsidiaries

2. Pace the business:

- Positive / Neutral are preferable to negative reactions
- Structured progress, working to a plan and realistic timetable

3. Standardise data collection:

- Per business, per country
- Covering the anticipated areas (i.e., tax, legal, treasury, controllers)

4. Complex and international proliferation of subsidiaries:

- Benefits for all disciplines to simplify
- Build legal integration into future acquisition process
- Unearth and simplify investments
- Long-term and unexpected benefits from shining a light on the whole group

5. Dissolution techniques in armoury:

- Merger (non-UK or cross-border)
- Liquidation
- Informal striking off

6. Intragroup trading and loan balances can prove the largest single items to address:

- Good to eliminate in principle
- Various traps and reliefs for intra-group arrangements

Summary

As with all corporate planning, achieving any successful outcome can only come about by identifying the desired benefits, assessing the costs, making the decision and then implementing the new structure. The overall goal should be significant cost savings and an optimised legal entity structure that is more aligned with the business.

With a better understanding of what is involved in the LER process, intuitive companies can not only simplify governance and administration structures, but recognise significant financial and tax benefits.

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