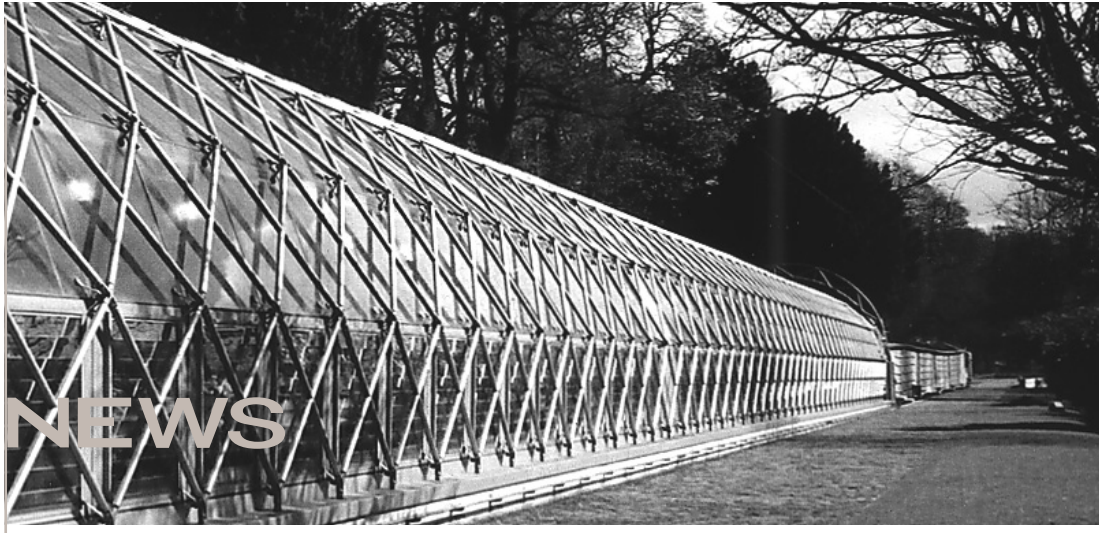
NELLEN NEWS



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Raising the Audit Threshold

Legislation raising the audit threshold for small companies from £1m of turnover to £5.6m is expected to come into force this month. At the same time the definition of medium-sized companies is being raised.

Small companies (with some exceptions, such as financial services companies) with a turnover, balance sheet total and employees below the thresholds will not be required to have an independent audit of their annual accounts. Medium-sized companies will be exempt from certain financial reporting requirements.

The thresholds for small and medium-sized companies are respectively - turnover, £5.6m and £22.8m; balance sheet total, £2.8m and £11.4m; number of employees, 50 and 250.

All annual accounts must continue to be prepared in accordance with statutory requirements – showing a true and fair view and complying with accounting standards - and be delivered to Companies House. However, the report of the auditor to members that in their opinion the accounts have been properly prepared and give a true and fair view, will no longer be necessary for small companies.

Wide Consultation

The Government consulted widely on the proposals but concluded that although independent audits benefited shareholders and creditors, the financial burden outweighed the benefits. It felt that companies should themselves be allowed to make the choice. A majority of companies falling into the new exempted category were likely to continue filing audited accounts because of the benefits an audit brings, for example in enhancing the credibility of the figures.

Minority shareholders owning at least 10% of the share capital who are concerned about the absence of an audit have the right under the Companies Acts to require an audit.

Recent Transactions

NELLEN has recently advised:

- **Wanderlust Publications Limited,** the leading travel magazine publisher, in connection with the 50 per cent equity investment by publishers John Brown and Mark Ellingham.
- **Magus Research Limited,** the content and information management software supplier, on its purchase of Vrisko Limited, the information solutions software company.
- **Saint Germain Limited,** the UK distributor and retailer of **Dyptique** products, in connection with its equity financing and its distributorship and licensing agreements.

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Company Law

Unfair Prejudice of Minorities

One of the most active areas of company litigation in 2003 was section 459 of the Companies Act. Section 459 allows minority shareholders to apply for relief from the court where the majority is conducting the company's affairs in a manner which is "unfairly prejudicial" to that minority.

However, in many cases the minority will be disappointed with the protection offered by section 459. Judges have continued to apply a fairly strict reading of the section.

The seminal decision of *O'Neill v Phillips* held that relief will only usually be given where there has been some breach of the terms on which it was agreed that the affairs of the company be conducted (e.g. the Articles of Association or shareholder agreements) or where there has been conduct which is contrary to "good faith". The onus of proof falls on the minority – and the court will be reluctant to intervene if the minority's claim under section 459 amounts to no more than bad management.

The guidelines set out in *O'Neill v Phillips* have been applied during 2003 on several occasions. *Lloyd v Casey* brought partial success to the minority. Claims of unfair prejudice were upheld in relation to increased service charges paid to the majority shareholder's company (with no actual increase in service) and increased payments made to his pension fund. However, there was held to be no unfair prejudice in relation to the further claim that the majority's remuneration was excessive. The question is largely one of degree.

Minorities will need to be confident they can meet the *O'Neill v Phillips* guidelines before applying for relief under section 459.

Employment

Termination Payments

The Inland Revenue scrutinises lump sum payments which are paid free of tax (i.e. gross) on termination of employment. In many cases, termination payments will be exempt from tax up to the £30,000 limit but the circumstances must justify gross payments. A payment will be taxable as earnings if it is payment in respect of services rendered or is in fact deferred pay or payment for future services.

To be within the exemption, payments must be by way of compensation because the employer has broken the employment contract, or the payments must be genuinely ex gratia. Where an employment contract gives the employer the option to make a payment in lieu of notice (which is often the case), the lump sum payment in such circumstances will not be regarded as compensation for breach of contract. Sums paid in return for the employee entering into restrictive covenants will also taxable.

Even if the employer believes it is entitled to make gross payments, it is good practice to require a tax and national insurance indemnity from the employee.

Enterprise Management Incentives

Disqualifying Events

As of January 2004, approximately 4,000 EMIs have been notified to the Inland Revenue. EMIs are clearly now the preferred share option scheme for SMEs.

However, the tax favoured capital gains tax status of an EMI option can be lost by a "disqualifying event", something which companies need to keep under review. The effect is that the gain in value of the shares from the happening of the disqualifying event to the date of exercise of the option is subject to income tax if the option is not exercised within 40 days after such event.

The main disqualifying events are:-

- The loss of independence - becoming a 51 per cent subsidiary or coming under the control of another.
- The company no longer meeting the trading requirements - carrying on business substantially in the UK or to a substantial extent carrying on excluded activities (such as financial services or dealing in land).
- The employee being no longer eligible.
- Any alteration to the share capital of the company whose shares are under option if it increases the value of the shares under option and is not made for commercial reasons.

Client Profile: Vitra

Vitra is one of the world's most original and innovative manufacturers and distributors of furniture for offices, public spaces and for the home.

Its name is admired for the quality of its products and originality of its designs – a process, which is directed from the Vitra Centre in Birsfelden, near Basel and from its manufacturing base near the German/Swiss border at Weil am Rhein.

The Vitra spirit is reflected not only in its products, but at the very heart of the group – the Vitra Centre (see photograph) was designed by Frank O. Gehry in 1994 and its manufacturing base is an architectural arboretum and a destination in its own right. Buildings by Tadao Ando, Nicholas Grimshaw, Zaha Hadid, Frank O. Gehry and others adorn the rural plains.

The Eames Connection

Vitra's origins, and those of Vizona its shop fitting sister company, date back to the 1934 purchase of a shop fitting business by Willy Fehlbaum, the father of Rolf and Raymond Fehlbaum, the present generation of what is still a family controlled private company. Twenty years later the company began manufacturing under license the Herman Miller Collection and its designs by Charles & Ray Eames. Vitra later purchased the European and Middle Eastern rights to the complete Eames product range, comprising well known icons such as the Lounge Chair and the Aluminium Chair Group.

Today, with nearly 900 employees and a turnover of approximately €230 million, Vitra has achieved international status. The Vitra Classic products from the Eames', Nelson's and Panton's range can be seen at Vitra Limited's showroom in Clerkenwell Road, London, and in its showrooms throughout the world.

Stimulate, inspire, motivate

Vitra's philosophy of making furniture, that "stimulates, inspires and motivates" and that takes into account "ergonomics, safety and comfort", means that it works with the world's leading designers such as Alberto Meda, Mario Bellini, Antonio Citterio, Philippe Starck and Jasper Morrison.

Vitra's furniture has won numerous design and industry awards, including the coveted "Bundespreis für Produktdesign" for the Meda Chair.

The Vitra Design Museum

The Vitra's holistic approach to innovation and design led it to set up the Vitra Design Museum in Weil am Rhein in 1989. The Frank O. Gehry designed museum – a smaller precursor of the Guggenheim Museum in Bilbao - was Gehry's first European commission. In the last ten years the Vitra Design Museum has contributed significantly to raising popular awareness of design and architecture. Drawing on its collection on the history of industrial furniture design, the Museum devises a constantly changing exhibition programme to show at museums throughout the world. The programme is enhanced by the Museum's publications, workshops and products. Over 60,000 people now visit the Vitra Design Museum's exhibitions in Weil am Rhein every year, whilst its travelling exhibitions attract more than 2.5 million visitors worldwide.

The pressures on European manufacturers are huge, yet the skill of Vitra's craftsmen, the consistent quality and durability of its products and the innovation of its designs ensures that Vitra's products are the first choice for specifiers. See more on www.vitra.com

NELLEN has advised Vitra Limited for a number of years on a range of commercial and corporate matters including large customer contracts, agreements with distributors and on the relocation to its London headquarters and showrooms.

Employee Shares

New "Restricted Share" Regime

The tax treatment of shares awarded to employees has changed dramatically in the light of the new Income Tax (Earnings and Pensions) Act 2003.

The new legislation applies where there are restrictions attached to the shares - for example, voting restrictions or a requirement for leavers to sell their shares for less than their market value – which depreciate their market value.

The intention of the legislation is to attack provocative schemes which were designed to lower the value of shares awarded to employees so as to reduce the charge to income tax and increase the capital gains upon sale. Any share plans or transactions involving employee shares subject to restrictions will now need to be carefully analysed.

The new regime is complex, but the general effect is that, unless an election to the contrary is made:

- Income tax will be chargeable when restrictions are varied or removed (to reflect the value enhancement as a result of that variation or removal or restrictions).
- There will be an income tax charge on sale. A percentage of the sale price will be chargeable to income tax equal to the percentage by which the restrictions reduced the original market value of the shares. For example, if the original market value of the shares was depreciated by 80 per cent by the use of restrictions, then, broadly, 80 per cent of the sale price will be chargeable to income tax. The balance will be chargeable to capital gains tax.

The income tax charge on sale could therefore be substantial. Employees and employers may however elect to pay income tax upfront on the issue of the shares rather than being charged when restrictions are varied or removed, or when the shares are sold.

Corporation Tax

Tax-Free Sales of Substantial Shareholdings

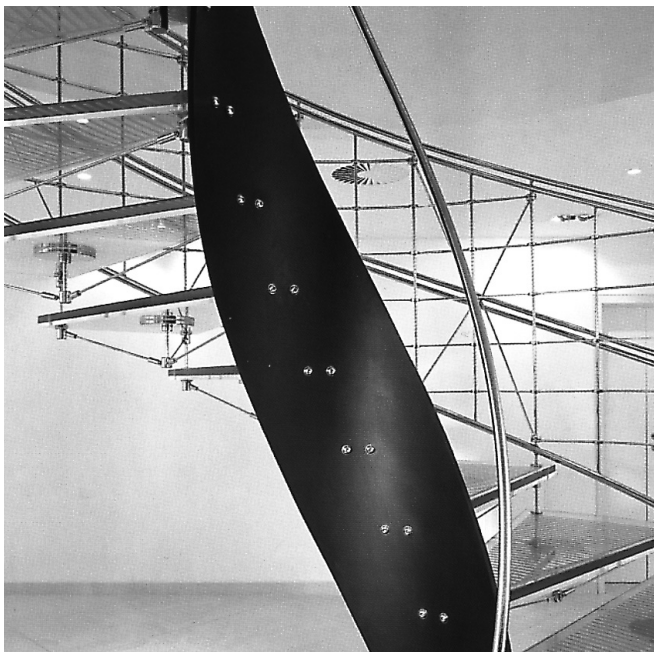
Since 1 April 2002 UK resident companies have been able to sell substantial shareholdings in trading companies free of corporation tax on capital gains provided various conditions are met.

The exemption applies to companies which hold at least 10 per cent of the ordinary shares in the relevant trading company and provided the shares have been held for at least 12 months in the two years before the sale.

For the exemption to apply, the trading status of both the company whose shares are being sold and the purchaser is crucial. Broadly, the company being sold and the purchasing company must be trading companies. A company will not be regarded as a trading company if it carries on activities "to any substantial extent " which are non-trading activities. This is assessed using the same criteria the Inland Revenue has used for the test of business asset taper relief - "substantial" is taken to mean 20 per cent measured by the proportion of income, assets and management time derived from or employed in the non-trading activities.

New Hire

- **Katie Lacy-Hulbert BSc** joined NELLEN as Office Manager in October 2003. After gaining her Psychology and Business degree, Katie moved to the Cayman Islands for two years, where she worked in a similar role for a small law firm. Katie is responsible for all aspects of NELLEN's administration.



Recent Transactions

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NELLEN advised:

- **Prospectus Limited,** the leading recruitment consultancy in the not-for-profit sector, on its purchase of the design and advertising consultancy Source Communications UK Limited.
- **Jasper Morrison Limited**, the design consultancy, in connection with product design licence agreements.
- **OneClick HR plc** (HR software) and **Bodas Limited** (designer and retailer of underwear), on equity investments in these companies.

Photographs: Cover and Page 2: Orangery Prague Castle; Page 4: Staircase Hotel Josef Prague: Eva Jiricna Architects Ltd.