



Selling a business – the key issues



Key issues

There are a variety of reasons why you might want to sell your business. Probably the most common is when you want to retire, but maybe you are in the lucky position of being able to sell out to a larger organisation. Or maybe you are a serial entrepreneur and just want to move on to your next business venture.

There is a variety of tax consequences to selling your business, and these will depend on whether you sell for cash, receive shares or loan notes in exchange for your business, or a mix of each. One popular arrangement is the 'earn-out' where the final sale price is based on the future performance of your business following its sale – typically over a three to five-year period. With an earn-out, you remain involved in the business and will have to 'earn' the deferred proportion of the sale price. If you are selling a company, then you will have to decide whether to sell the company itself (your shareholding) or the company's business and assets.

Not surprisingly, what suits you as a seller will usually not suit the buyer. For example, you will no doubt prefer to be paid in cash, but the purchaser (if the sale is to a company) may offer shares or loan notes. If you are selling a company then you will probably want to sell the company, but a purchaser may prefer buying the business and its assets, which is a far simpler arrangement from their point of view. If the purchaser takes over the company then they also take over any hidden liabilities.



Focus point

Structuring your affairs to ensure that the maximum possible entrepreneurs' relief is available when the business is sold can provide a major tax saving.

The most important tax consideration will normally be whether or not entrepreneurs' relief is available as this reduces the rate of capital gains tax (CGT) to just 10%. The tax situation can be particularly complicated if you sell the business and assets out of a company. Your company will pay corporation tax on the gains that arise from the disposal. You then have the problem of extracting the proceeds from the company, and this can result in a double charge to tax – but not so much of a problem if you are planning to use your company to set up or acquire another business. You can extract the proceeds by taking a dividend, paying yourself remuneration, or liquidating the company. Each option has different tax consequences.

Good planning at an early stage will ensure that you do not pay more tax than necessary – in fact, it's a good idea to think about the eventual sale of the business even as you are setting it up.

Capital gains tax

You are likely to pay CGT when you sell a successful business. Entrepreneurs' relief will reduce your rate of CGT on certain disposals to 10%, so it is important that you meet the qualifying conditions whenever possible. There is currently a lifetime limit of £10 million of qualifying gains, so this will cover all but the very largest of disposals.

- If you run your business as a sole trader or as a partnership, then entrepreneurs' relief will apply for any assets used for business purposes. The business must have been run for at least one year to qualify.

- If you run your business as a company, then entrepreneurs' relief will be available provided the company is a trading company, your shareholding is at least 5%, and you are an employee or director. The one-year rule applies to all three conditions. If your company has more than 20% of non-trading activities, income or assets it will probably not qualify as a trading company, but it may be possible to rectify this situation prior to a sale.
- Relief is also available for associated disposals. This is where you own assets personally that are used by your company or by a partnership if you are a partner. The disposal must take place at the same time as the main disposal, and relief will be restricted if you have been renting the asset to the business.

If the disposal (or some aspect of it) does not qualify for entrepreneurs' relief, then gains are taxed at the rate of 18% up to the level of your basic rate tax band, and at 28% thereafter. So the availability of entrepreneurs' relief can result in a considerable tax saving. Certain costs can be deducted when calculating gains, such as the legal fees incurred in arranging the sale.

Sole trader

Where you are disposing of a sole tradership, then gains will be calculated separately on each chargeable asset. These assets are mainly land and buildings, and intangible assets such as goodwill and trademarks. Goodwill will be the difference between the total sale price and the value placed on the net assets of the business (assets less liabilities). The same principle applies if you are selling the business and assets of a company except that the company will be subject to corporation tax rather than CGT. If you are selling your company, then CGT will be charged on the gain on selling your shareholding. This is broadly the sale proceeds less what you paid to buy or subscribe for the shares.



Focus point

When starting in business, careful consideration should be given to the type of business vehicle to be used. While it is true that there are tax advantages from the use of a company, one of the major potential drawbacks is the possible 'double taxation of capital gains' when it is time to sell.

Partnerships

As regards a partnership, each partner owns a share of each of the business assets. So the sale of a partnership's business will mean that a partner is liable to CGT on the gain arising on their share of each asset. Entrepreneurs' relief is available if a partner has owned their share of the assets for at least one year.

Earn-out

With an earn-out, part of the sale proceeds will be deferred. The actual amount you will ultimately receive will not be known at the time of sale, so an estimated market value must be included in the proceeds figure representing the right to receive future payments. If the amount subsequently received is higher, then the additional proceeds will be treated as a separate disposal. However, where part of the proceeds is payable later but this amount can be established at the time of sale, you will be treated as making just the one disposal. Since CGT will then be payable before some of the proceeds are received, you may be able to pay tax by instalments.

Sale of a company's business and assets

Sometimes a purchaser will not want to buy your company, but will instead prefer to buy the company's business and assets. The purchaser may have good commercial or tax reasons for wanting to take this route, although this type of sale is likely to result in a higher tax cost for you. This is because the company first pays corporation tax on the sale of the business assets, and then you will have to pay income tax or CGT when withdrawing the sale proceeds from the company.

Sale for shares or loan notes

You will probably prefer to sell your shareholding for cash, but the purchasing company may offer shares or loan notes – or the proceeds may be a mix of each. Taking shares or loan notes is riskier than a sale for cash because securities can fall in value, and unquoted shares can be very difficult to sell. And there is always the possibility that the purchasing company will fail. Whether you decide to accept securities will depend on your bargaining position (i.e. how desperate you are to sell) and whether the sale price is higher than that for a cash sale.

One major advantage of taking securities is that you will not have any immediate CGT liability. The gain on the disposal of your shares will be rolled over until the replacement securities are disposed of. You may be able to make use of several years' annual CGT exempt amounts, but in some cases you will lose the benefit of entrepreneurs' relief.

You might receive securities on the sale of a business run as a sole tradership or partnership. This does not, in itself, defer your CGT liability, but you could obtain CGT deferral by incorporating your business prior to it being sold.

Capital gains tax planning

It is important to take professional advice either at or before the start of the sale negotiations. This may enable you to structure the deal so as to reduce the amount of gains that are liable to tax. Advice is especially important if the sale price includes an element that is dependent on future performance. These arrangements have complex tax consequences and involve a certain amount of risk.

Ways of reducing CGT include:

- Making use of your spouse's or civil partner's annual CGT exempt amount by transferring assets to him or her before the sale. Passing assets this way is free of CGT. You can also make use of your spouse's or partner's basic rate tax band so that gains are taxed at 18% rather than 28%.
- Reinvesting your gains in shares that qualify under the enterprise investment scheme (EIS) so that your gain is deferred until the EIS shares are sold. Investment in EIS shares may also qualify for 30% income tax relief. You must reinvest within a period starting one year before and ending three years after the sale of your business. This is generally a high-risk strategy because the reinvestment must be in unlisted shares in a company carrying on a qualifying trade.
- Reinvesting your gains in shares that qualify under the seed enterprise investment scheme (SEIS). Half of any reinvested gains will be exempt from CGT, although relief is restricted to £100,000. Investment in SEIS shares will also qualify for 50%



Focus point

Great care is needed when structuring the sale of your business, because these deals can be fraught with tax and other difficulties for the unwary.

income tax relief. However, reinvesting in SEIS shares is an extremely risky way to save tax because the company in which you invest must be 'small' (i.e. with 25 or fewer employees and assets of no more than £200,000), and either be carrying on a new business or preparing to do so.

There is one other way to avoid CGT, and that is to dispose of your business during a period of non-UK residence (although it will be necessary for you to stay overseas for five years). But given the difficulty of selling a business when you are not resident in the UK, this option is unlikely to be worthwhile if entrepreneurs' relief is available.

Income tax

If you sell your sole tradership, this is likely to affect your income tax position for the year of disposal. Your income may be lower because you do not have a full year's profits, or it may be higher because the assessment rules mean you are taxed on more than a year's profits in the final year of trading – which can happen if your accounting year is not the same, or nearly the same, as the tax year. In this situation, however, 'overlap profits' may have arisen when your business started and these can reduce the amount taxed on the sale.

If you sell business equipment on which you have claimed capital allowances, you may have a balancing allowance, which will reduce your taxable profit, or you may have a balancing charge, which increases it.

Selling a partnership's business will have similar tax consequences.

Value added tax

You will not have any VAT to pay on the sale of your business if it is sold as a going concern. For this treatment to apply, the buyer must be registered for VAT and use the assets in the same kind of business that you are selling to them. You must make sure the conditions are met; otherwise you could be liable for VAT on the sale proceeds. The following situations should be avoided as they will result in the conditions not being met:

- **Where there are consecutive transfers.** This is where the buyer immediately sells assets onwards without having carried on the business.
- **Where there is a significant break to the normal trading pattern** before or immediately after the sale.
- **Where the business is not a going concern** at the time of sale.

If the going concern conditions are not met, then you will have to pay VAT on those assets where you have claimed back VAT – stock, equipment, fixtures and fittings and possibly property. However, you may be in the situation where you are better off selling your business premises separately despite the VAT costs of this arrangement.

There is no VAT on the sale of shares in a company. As regards the company's business, this will not have altered because the business remains in the company – so there will no VAT consequences for the company.



Focus point

Exempting or deferring capital gains by investing in one of the enterprise investment schemes can be a useful way of reducing the initial CGT cost of your business disposal. The relatively high-risk profile of the companies involved in these schemes means they may not be suitable for all taxpayers.

What a buyer will be looking for

It helps if you know what a buyer is looking for and why they acquire businesses. Buyers are influenced by a range of factors in their purchasing decisions, including one or more of the following:

- A purchase might be the fastest way for a buyer to increase sales or to break into a new market.
- Buying a business has several advantages compared to setting up a business from scratch. A market for your product or service will already have been demonstrated, there will be established customers, and your employees will already have experience. It may therefore be easier to obtain finance as the business will have a proven track record, and many of the problems encountered with a start-up will have been discovered by you and solved.
- Your business may be profitable in its own right, or the buyer might hope that profitability will follow the purchase as a result of increased economies of scale from the combined businesses.
- It might be that the buyer wants to purchase a tangible asset you own, such as your business premises, or some business attribute or asset such as a brand, intellectual property or some other technology or capacity.
- Your business may have the expertise the buyer particularly wants. This could be a well-trained and motivated workforce – sales, production or management. It would then be important that the key people stay on after the purchase takes place.
- In some cases a buyer may simply want to remove a competitor from the marketplace.



Focus point

If you are a key part of the business's success, then a buyer may be prepared to pay more if you stay on for a fixed period as an employee or consultant.

Preparing a business for sale

In the light of knowing what a buyer wants, you should consider how best to prepare your business for a potential sale. This will include:

- Having some years of reasonable and consistent profitability – preferably showing some growth.
- Ensuring that contracts with suppliers and customers are in order.
- Securing assets such as intellectual property.
- Checking out any potential threats such as potential litigation.
- Making certain that the key staff are in place and are likely to remain. Ideally, it should be possible for the business to be run independently without your involvement.

You may decide to market your business yourself, but be warned that this can be more difficult than you may think. The last thing you want is employees or competitors becoming aware that your business is up for sale. Advertising is the obvious initial route, and most sellers will use one of the major internet sites.

However, if you are hoping to attract a venture capitalist or private investor then it will almost certainly be necessary to use an agent to represent you. But check their experience, knowledge of your business sector, and their track record.

Setting the selling price will probably be the most difficult aspect of the sale process. There are various models that you can use based on either your business's profitability or its assets. There is no right approach, and it may be a case of coming up with a price range rather than a specific figure. If you are a key part of the business's success, then a buyer may be prepared to pay more if you stay on for a fixed period as an employee or consultant.

Due diligence and warranties

Once the buyer has made an offer, you will have to allow them due diligence – a period of time when they can access your books and records. The buyer will want to confirm how the business is currently performing, get an idea of what the future holds, and also identify any issues or problems that might need warranting or indemnifying.

A purchaser buys a company with all its actual and potential liabilities. For this reason, if you are selling a company the buyer is likely to request a wide range of warranties and indemnities from you. Precisely what warranties and indemnities you actually give will form an important part of the negotiating process.

How we can help

We can advise you at all stages in the life of your business on ways of minimising tax on its eventual sale. When it comes to a sale we can help you to negotiate the best deal, balancing price, risk and tax.

The sale negotiations are often long and complex. We are experienced in helping clients through them and dealing with the many accounting issues likely to arise, working closely with your solicitors.

When you have spent your lifetime building up your business, you deserve the best deal on its sale and the best advice to help you achieve it.

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