Selling your business?

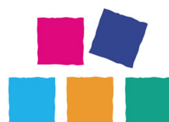
The impact of the current economic climate and the fact that many baby boomers are now retiring is having an increasing effect on the number of business owners looking to sell and pursue other interests.

The effect of government policies, turbulence of stock markets, low savings returns and the lack of available finance for business acquisition for small businesses means that disposing of a business interest requires careful planning and timing.

This guide looks at the tax implications of the sale rather than the mechanics of selling. Tax changes introduced in 2010 changed the landscape for the slice that is payable to HM Revenue and Customs and as your tax advisers we thought you might find this update of interest.

The sale of a business usually starts by considering the commercial implications before looking at the tax implications:

- First, the parties need to be clear regarding what is actually being sold. There is a huge difference between selling a business as a going concern and selling the assets of a business. The sale of a business as a going concern is outside the scope of value added tax, for example.
- Second, the buyer will be concerned about contingent liabilities. A purchaser of a business does not want to receive a lawsuit relating to a pre-acquisition matter. Typically a purchase agreement for a business is a long document and contains many warranties from the seller. This is a document that is normally prepared by lawyers which we are happy to review. It is a document that you cannot afford to get wrong.



FALLOWS&COMPANY
CHARTERED ACCOUNTANTS

Fallows & Company | 020 8399 4715
info@fallowsandcompany.co.uk | www.fallowsandcompany.co.uk
Archway House 81 - 82 Portsmouth Road Surbiton Surrey KT6 5PT

These warranties will typically include many tax matters as these could otherwise create a nasty surprise for the buyer.

Tax issues that the buyer will expect to see addressed include:

- the capital base cost of assets — these could be significantly different from balance sheet values if there has been a claim for rollover relief or if the assets were acquired before March 1982;
- how any trading losses have been utilised — any unused losses may not always be available for offset when a business is sold;
- when the business last had an inspection from the tax authorities — if this was a long time ago, it could mean that errors have been made that could be expensive later on. This can be addressed by allowing us to check the tax records;
- transfers within a group — this is a specialist area of taxation. There are many detailed tax provisions, including degrouping charges and anti-avoidance law, which could create problems on a sale;
- dealings with directors and shareholders — loans, transfers of assets and gifts between the company and its directors or shareholders can create tax problems.

In addition, the purchaser will want to know that the tax affairs are up-to-date, that all due returns have been filed, there are no outstanding issues and that all elections that should have been made have been made.

If the business being sold is a close investment holding company, there are some additional tax implications.

The warranties must be compiled or reviewed by an accountant who understands the tax consequences.

THE SALE OF SHARES

A clear distinction must be made between selling the business and selling the assets of the business. In most cases, the issue is clear. It can be less clear when only part of the business is sold, or where the old business has closed down. We can advise you in such cases.

How a business is sold depends on how it is constituted. If it is a limited company, you sell your shares. The profit you make on those shares is a capital gain and this is subject to capital gains tax.

At its simplest the capital gain is:

disposal proceeds – acquisition cost = capital gain

So if you sell the shares for £3 million when they cost £1 million, your capital gain is £2 million.

In practice, the issue is rarely that simple. If you sell the shares to a "connected person" the disposal proceeds may be replaced by "market value." A connected person could be a son, sister-in-law or business partner. The market value of the shares is usually negotiated with HM Revenue and Customs. We will conduct that negotiation for you.

There are also implications if you sell a controlling interest in a business:

If you started the business yourself, you may think that your acquisition cost is zero. However there are costs that you may include.

The capital gain is then reduced by certain allowable expenses, such as stamp duty and certain legal fees.

The taxable gain may be reduced by more tax reliefs, of which the most important is entrepreneurs' relief. Others are gift relief and enterprise investment scheme relief. There is also an annual capital gains tax exemption.

ENTREPRENEURS' RELIEF

This relief applies for disposals of a business from 6 April 2008. In its short life, there have been three amounts of relief depending on when the disposal was made:

Date from	Amount of relief
6 April 2008	£1 million
6 April 2010	£2 million
23 June 2010	£5 million
6 April 2011	£10 million

This is a lifetime limit for each individual. You may claim the relief for any number of sales, and for any number of businesses (assuming the conditions are met), but the total may not exceed the amount of relief for the date you receive the proceeds.

For example, a man sells three parts of his business at £1.5 million each on 1 May 2009, 2010 and 2011.

This is how much entrepreneurs' relief he may claim

Date	Receipt	Cumulative	Limit	Relief
1 May 2009	£1.5 million	£1.5 million	£1 million	£1 million
1 May 2010	£1.5 million	£3 million	£2 million	£1.5 million
1 May 2011	£1.5 million	£4.5 million	£10 million	£1.5 million
Total relief				**£4 million**

He receives entrepreneurs' relief for £4 million. He does not receive full relief for the first payment as the payment of £1.5 million was £500,000 more than the then lifetime limit.

The effect of the relief is that (from 23 June 2010) you pay capital gains tax at the rate of 10% instead of at 18% or, more likely, 28%.

To qualify for entrepreneurs' relief:

- you must own at least 5% of the ordinary shares
- you must control at least 5% of the voting rights
- the company must be a trading company
- you must be an officer or employee of the company

These conditions must have been met for at least one year before the sale.

It may be possible to claim more entrepreneurs' relief by transferring shares to family members before the disposal, provided they meet the above conditions.

RECEIVING SHARES FOR A BUSINESS

Often when a business is sold, the acquiring company does not pay in cash but gives the seller shares in the company.

For example Company A with 1 million shares worth £5 each takes over your company worth £500,000. Rather than find £500,000 which may be difficult for Company A and not be wanted by you, it is likely that Company A will give 100,000 shares in itself to you.

The advantages to you are:

- you are likely to get a better "price" this way;
- you do not pay capital gains tax on disposing of your shares.

There are some conditions and anti-avoidance rules to be aware of, but we will review these with you.

Sometimes an acquiring company may offer you loan notes or similar. This means that the company owes you money. They are not shares.

For tax purposes, loan notes are treated as either:

- qualifying corporate bonds (QCBs); or
- non-qualifying corporate bonds (non-QCBs).

The distinction is important as QCBs are exempt from capital gains tax but non-QCBs are not. We will advise you on whether any loan notes qualify as QCBs.

If you receive shares or QCBs for a disposal, it may be possible to realise your profit by selling them over several years. This can spread the gain over several years and utilise several years' annual exemptions.

These are only some of the implications of selling a business. There are many others relating to tax and non-tax matters. We can advise you regarding how to minimise the tax liability come the day you decide to sell your business.