Time to sell up?

Sooner or later, most owners of a business want to retire. **Gary Morley** looks at how to plan a business sale, while **Andrew Shilling** considers the tax implications and suggests the best ways to minimise the taxman's cut

It is quite common for sons or daughters not to have any interest in wanting to run the family business. Experience shows that it is wrong to try and cajole family members into taking on the responsibility of running a family business if they do not want to.

So how do owner/managers maximise the return on the business they own? The good news is that the maximum rate of tax on the profit from the sale of a business is unlikely to exceed 10 per cent.

Once you have taken the decision to sell, the first thing to do is to market the business. This could be to trade contacts you may already have or to advertise in publications such as OPTICIAN.

The prospect of selling to a local competitor may fill you with dread, but it could make financial sense for both sides – even if it's only for them to remove a direct competitor. If you don't want to sell to a competitor you

Taxing affairs

Unless the sale is executed correctly, a business owner could face a large, and mostly unnecessary, tax bill. So how do business owners minimise their tax bills when selling up?

Most businesses are contained within companies in which the business owner holds shares. Many buyers wish to pursue 'asset deals' where they buy the business directly from the company, rather than buying shares in the company. On the other hand, almost all sellers prefer to sell shares in the company.

These preferences are largely driven by tax considerations.

For the seller, the key tax driver is the desire to achieve a sale that is taxed at only 10 per cent by utilising the generous business asset taper relief (BATR). Where the business is contained within a company, this 10 per cent tax rate can only be achieved by selling shares.

The buyer may, however, wish to undertake an asset deal because the buyer will then acquire none of the historic attributes of the company, tax or otherwise. In addition, if the buyer is a company, it will have the ability to deduct any goodwill paid on the acquisition of the business against its future corporate tax liabilities.

However, an asset sale is potentially disastrous for the seller. This is because an asset sale will be taxable in the seller's company and liable for corporation tax at 30 per cent. In addition, the sale proceeds will be received by the company, not the seller, and a minimum of 10 per cent of further tax will be payable when stripping the sale proceeds out of the company into the seller's hands.

All told, the seller could face a tax bill of at least 40 per cent of the sale proceeds by agreeing to an asset sale, whereas a share sale should result in a tax bill of only 10 per cent of the sale proceeds.

CASH BALANCES

The generous 10 per cent tax rate offered by BATR in a share sale has a number of conditions attached. The main condition is that the owner has held shares in a 'trading company' for at least two years.

The definition of a 'trading company', and the Inland Revenue's approach in applying this definition, is where problems frequently arise, especially where trading companies hold large cash balances. In these situations, the Revenue may deny the

could also try selling through websites such as *www.daltonsbusiness.com* and *www.christie.com*. If you are hesitant about making public the sale of your business you could get your accountant and solicitor to front it for you and vet enquiries on your behalf. Alternatively you could use a PO Box number.

Whichever way you go about marketing, you need to furnish prospective purchasers with sufficient information for them to make an informed decision on the attractiveness of your business and its value.

You therefore need to produce a small pack of information which, as a minimum, should include the following:

◆ Brief history of the business
◆ Your brief history
◆ Terms of business you get from your suppliers
◆ Terms of business you give to your customers
◆ List of staff with ages and length of service (possibly with salaries)
◆ Full details of the premises
◆ Any unique sales points of your business
◆ Latest set of accounts
◆ Details of items in the accounts that relate to you or your family.

You may ask potential recipients of the above information to sign a confidentiality undertaking. While this is good practice it is very difficult to rely on such an agreement.

GOLDEN RULES

One of the 'golden rules' of selling a business is never give your asking price.

Remember, 'He who speaks first loses'. This will annoy some people, and despite their pleas to the contrary, nobody seriously interested will choose not to proceed with an offer just because they have to make an offer first. If you do speak first, then whatever price you give will be used as a ceiling.

But, the problem arises if all of your marketing efforts come to nothing. What do you do then?

All is not lost. If you have some able lieutenants in the business who you believe could run the business without you, you may be able to structure a deal that's acceptable to both sides. Any assets in the business such as stock, debtors, equipment, premises may be used by your team as collateral to borrow money against to pay you as part of the sale price. If the premises are freehold (or long leasehold) you could extract them from the business and rent them back. This has two advantages: it lowers the price of the deal to your guys and gives you an ongoing rental income in your retirement. And even if the business eventually fails under the new management it means you won't lose a valuable asset.

If your business has an element of trade customers, these could be used to raise funds via confidential invoice discounting. There are a number of lenders who are happy to put together a deal to raise funds using all the assets of a business. This is typically called 'structured finance'.

If this, together with any funds your team can produce from personal sources such as friends and family or borrowing some money against the value of their house, is not sufficient to raise the money you need then you could lend it to them.

This is not as strange as it may seem. The term 'vendor finance' is well known in the corporate finance world. No money actually changes hands – instead you get a promise of more money in the future – this can be a fixed amount on a fixed date or a variable amount depending on, say, the future profits or turnover of the business.

In addition, you could receive interest on this loan.

A variation on this theme is that you sell the business for share of future profits.

For example, as part of the deal, as well as receiving some money up-front you are entitled to 25 per cent of the profits for the next 10 years.

You would need some safeguards on how profit is determined and perhaps be able to veto certain transactions or have the cost of those transactions excluded from the profit share calculation. If you are considering going down this route there is one over-riding imperative. It is what venture capitalists call 'hurt money'.

CARROT AND STICK

You want your team to be totally committed to the business in which you still have a lot of money invested.

You need to know that it will hurt them to walk away, and while there is the carrot of them owning a business for little initial outlay, there must also be the stick of losing some money they have invested in the business.

Do not consider vendor finance unless each of the new owners has put their hand in their pocket. It does not need to be a lot of money in itself, but it does need to be a lot of money to the individual concerned. If you do not have people already in the business that are up to owning and running the business independently of you, then you could try to recruit such a person with the intention that they eventually own the firm.

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10 per cent rate, and instead tax the share sale at rates between 24 per cent and 40 per cent.

The tax rules define a trading company as 'a company carrying on trading activities whose activities do not include to a substantial extent activities other than trading activities'.

The Inland Revenue's interpretation is that 'substantial' means more than 20 per cent by reference to various criteria including assets, income and directors' time.

Therefore, if the value of non-trading assets, which could include excess cash, is substantial (more than 20 per cent) of total assets held then this could affect the trading status of the company, and therefore the availability of BATR.

Faced with this dilemma, what can owner managers do to protect their position?

Firstly, it should be remembered that the 20 per cent limit only relates to excess cash. Arguing that additional cash is needed as working capital to meet outstanding and ongoing fluctuating liabilities can justify all or some of the cash retained.

The cash may also be earmarked for specific expansion of the trade or the acquisition of a new business.

In addition, owner managers should undertake a regular and constant review of the company's activities, to ensure that where possible any non-trade assets, including excess cash, are kept within the 20 per cent limit.

TIMING THE SALE

The timing of any sale is also important is in establishing when the resulting tax liability is payable.

If the shares in the business are sold on or after April 6, then the owner's capital gains tax bill is payable on January 31 in two years' time. However, if the shares in the business are sold before April 6, then the owner's capital gains tax bill is payable on January 31 in only one year's time.

Selling a business is fraught with tax complications and tax pitfalls, and is likely to be scrutinised in detail by HM Revenue & Customs.

However, provided the seller obtains professional tax advice and negotiates in a tax-informed manner with the buyer, it should be possible to obtain a tax rate of only 10 per cent of the sale proceeds.

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