AUDIT • TAX • ADVISORY

Private Client & Entrepreneurial Business

Business Sale or Exit

7th April 2022

Now, for tomorrow

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Our Speakers

James Kipping

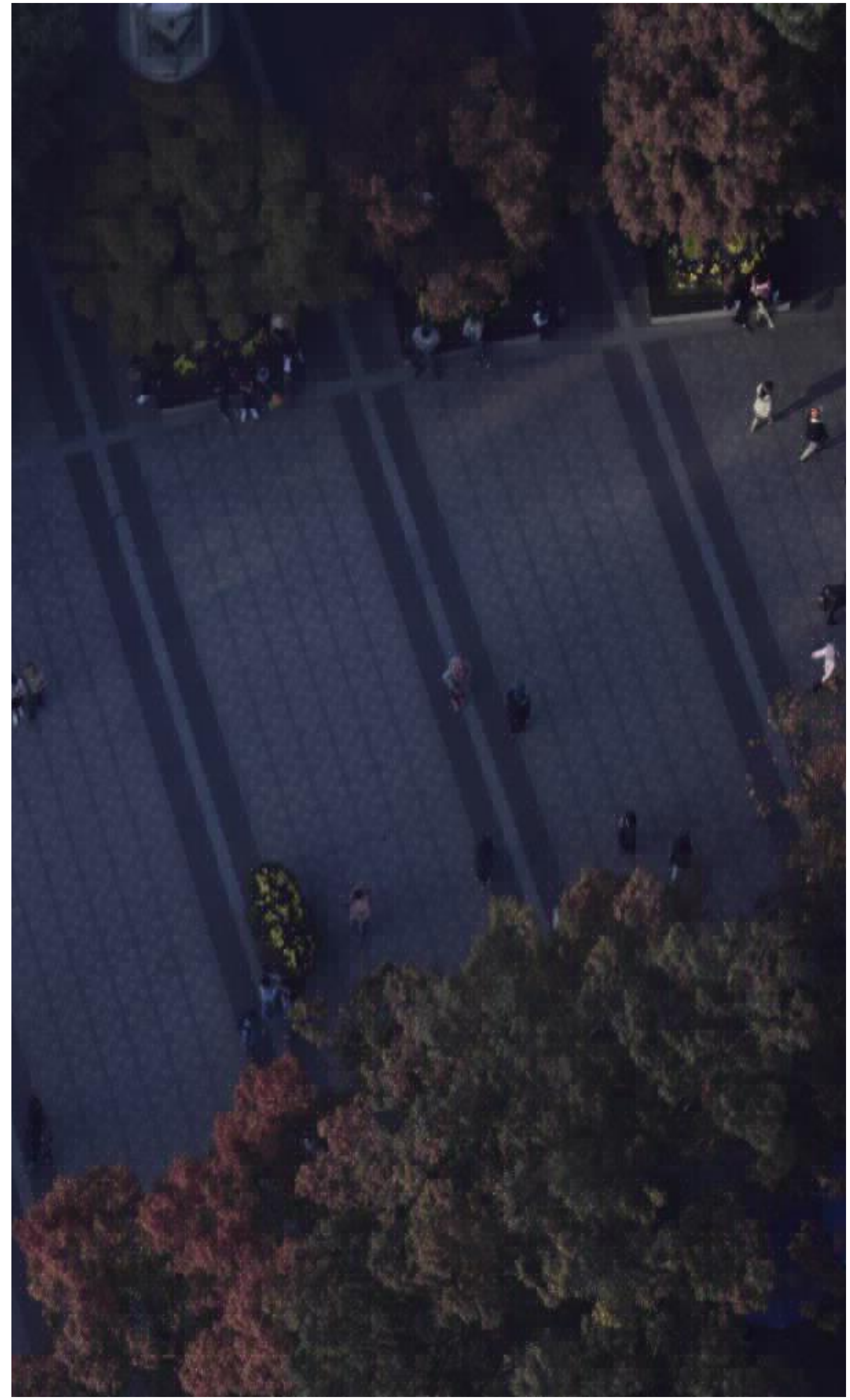
Tax Partner & Head of Private Client

Tony Medcalf

Tax Partner

What will be covered …..

1. Preparing your business for sale
2. Business Asset Disposal Relief (“BADR”)
3. Incentivising Key Employees
4. What are you selling, and to whom?
5. Shares or Assets?
6. Third Party sale /Management / Family
7. Tax considerations when structuring the consideration
8. Pre-sale planning opportunities – pensions /retention of cash



Preparing your business for sale

- Get ready now !

- Areas to review:
- Maximising relief's - capital gains tax & inheritance tax.
- Share ownership structure.
- Business Asset Disposal Relief ("BADR").
- Ensure shareholding maximises BADR.
- Shares into trust – 7 year clock.

- Making yourself redundant - incentivising Key Employees.

- Business structure.

- Business property.

Tony Medcalf
Tax Partner

Business Asset Disposal Relief ("BADR")

- CGT at 10% on first £1m of qualifying lifetime gains per person.

- Qualifying conditions satisfied throughout the 24 months prior to the disposal:
    - The company must be a trading company or the holding company of a trading group;
    - The individual must be an officer or employee of the company or a member of the group; and
    - The individual must hold 5%+ of the ordinary share capital, the voting rights of the company, and
    - They must also be either beneficially entitled to at least 5% of the profits available for distribution/assets on a winding up or 5% of the proceeds on disposal of the ordinary share capital.

- Ensure you review
    - Employment status
    - Directorships
    - Shareholdings of family members.

Tony Medcalf
Tax Partner

Incentivising Key Employees

- Enterprise Management Incentive - approved ‘tax advantaged’ share option scheme designed to encourage employee ownership of companies.
- Designed for small and medium-sized companies.
- A company is able to incentivise and retain specific employees, such as key management personnel.
- Very flexible in their design depending on the desired outcome.
- All of the growth in value of the shares from the date of the grant of the share option to the eventual sale is subject to capital gains tax (usually at 10% - more later) and not income tax (20%/40%/45%!) .

Tony Medcalf
Tax Partner

Enterprise Management Incentive

- Share Options - A right to acquire a specified number of shares in a company at a future date for a pre-determined price
- Shares – new or existing shares?
- Share type - participate in current value of company or just the growth?
- Exercise date – immediately, subject to performance conditions, on a sale - ‘exit only’?
- Exercise price – nominal value, market value or anything in between?

Tony Medcalf
Tax Partner

Enterprise Management Incentive…continued

Company Conditions	Employee Conditions
Trading companies	Must be an employee of the company or member of the group
Cannot be a subsidiary company	Work 25+ hours per week for the company (or if less 75%+ of their working time)
Gross asset <£30m	No material interest - > 30% of ordinary share capital (including unexercised options but not EMI options) and including share options held by associates
Employee numbers < 250 FTE	

Tony Medcalf
Tax Partner

Enterprise Management Incentive…continued

- Tax implications:
  - On Grant – no tax or NIC charge
  - On Exercise – income tax to the extent the employee does not pay market value at date of grant, i.e. tax on the discount. PAYE and NIC if shares a ‘readily convertible asset’
  - On Sale – capital gains tax reported by the employee under self-assessment

- Business Asset Disposal Relief
  - **No requirement** to hold 5%+ of the ordinary share capital/voting rights etc
  - The period that the individual holds the option (not the shares) can count towards the 24 month qualifying period, e.g. exit only options

Tony Medcalf
Tax Partner

What are you selling, and to whom?

- What are you selling ?
  - Shares in the company
  - Trade and business assets
  - Part of your business/subsidiary

- To whom ?
  - Third Party
  - Management / Employees
  - Family

James Kipping
Head of Private Client

Shares or Assets?

- Shares - usually beneficial
    - Capital tax treatment
    - BADR
    - Multiple consideration options

- Assets – may have no choice
    - Retain Company as an investment vehicle?
    - Extract over time?
    - Wind up and extract as capital (BADR?) BUT Anti avoidance!

James Kipping
Head of Private Client

Third Party Sale

- Most straightforward but could be various forms
    - All cash on sale
    - All cash but some or all deferred for a time
    - Cash plus an earn out based on future results
    - Cash plus paper of some form

James Kipping
Head of Private Client

Management / Employees

- Very common management team buys

- Often limited resources so various methods available
    - Company purchase of own shares plus team purchase
    - Newco buy out
    - Combinations including EOT

James Kipping
Head of Private Client

Family

- Gifts
- Family Trust
- Purchase of own shares
- Newco Buy out
- Combinations

James Kipping
Head of Private Client

Tax considerations when structuring the consideration

- Non-cash Consideration
    - It is common for part of the consideration for the sale of the shares to be in the form of shares or loan notes, or a combination of the two
    - Section 135 TCGA 1992: The original shares and the "new holding" (of shares or loan notes or both) are treated as the same asset, and the new holding inherits the base cost of the original shares
    - Unless the individual holds at least 5% of the ordinary share capital in the buyer, BADR will not be available on eventual disposal of the shares. In these circumstances it is possible to elect to disapply s135

- Loan notes take the form of Qualifying Corporate Bonds (QCB's) or Non-Qualifying Corporate Bonds (Non-QCB's) – deferral provisions can be disapplied in either case, if BADR will apply

- Deferred consideration
    - The CGT treatment of deferred consideration depends on whether it is ascertainable or unascertainable at the time of sale

James Kipping
Head of Private Client

Tax considerations when structuring the consideration…continued

- Ascertainable Consideration
    - Where there is a stated amount, but the right to receive it is contingent or it is paid in instalments, the whole gain is taxed up front
    - Where deferred consideration is not paid, the shareholder's liability to CGT is subsequently adjusted
    - Note that where the sale price is subject to adjustment following the preparation of completion accounts for the target, the consideration is regarded as ascertainable for CGT purposes
- Deferred consideration
- Unascertainable consideration, including earn-outs
    - Where the consideration cannot be ascertained, the seller is treated as making two disposals for CGT purposes
- First disposal is the sale of the Target
    - The proceeds are the ascertainable consideration plus the value of the right to receive the deferred consideration
- Second disposal is the disposal of the earn-out right when the further consideration is received
    - No BADR on second disposal

James Kipping
Head of Private Client

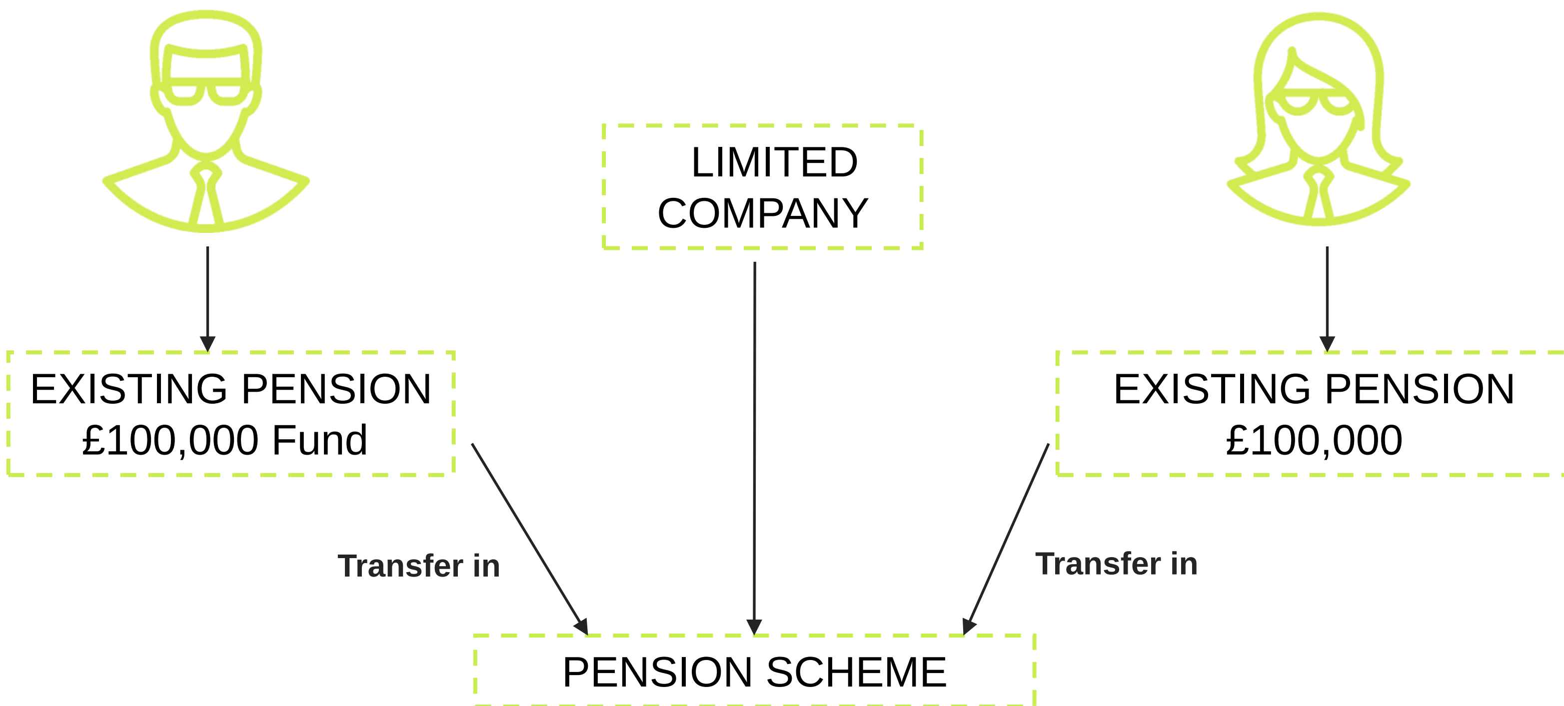
Pre-sale planning opportunities - release funds from pension

- Brad & Angelina

- Both own 50% shares in haulage company
- Company owns offices / warehouses from which it operates
- Year end 31 March 2023
- Company profit expected - £400,000
- Both have existing pensions valued at £100,000
- The offices / warehouse the company operates from has just been valued at £450,000. The assumed rental valuation is £36,000 (i.e. 8% yield)

Tony Medcalf
Tax Partner

Pre-sale planning opportunities - Use Pension Funds to Buy Building



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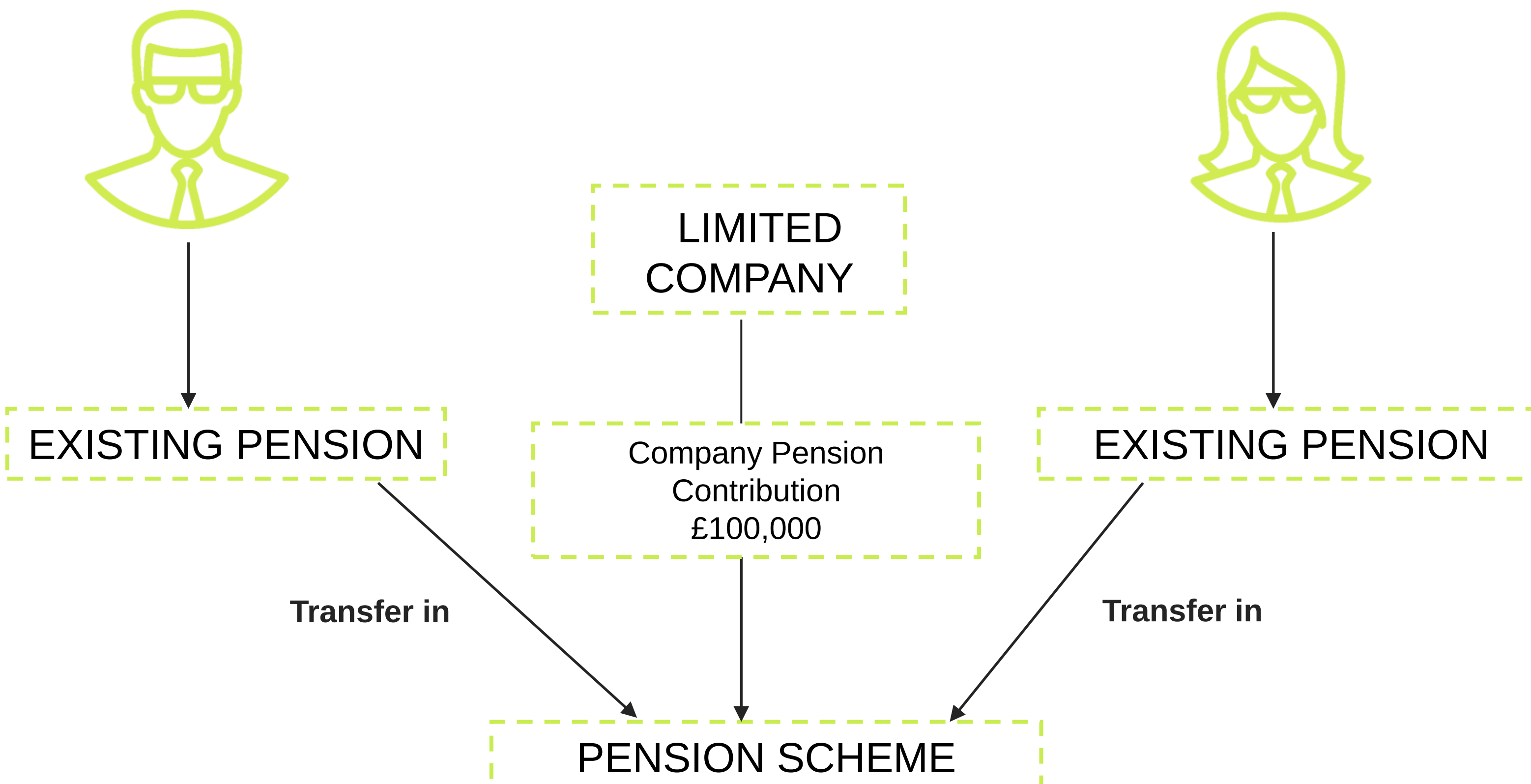

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Pre-sale planning opportunities - Use Pension Funds to Buy Building

LIMITED COMPANY

EXISTING PENSION

Company Pension Contribution £100,000

EXISTING PENSION

Transfer in

Transfer in

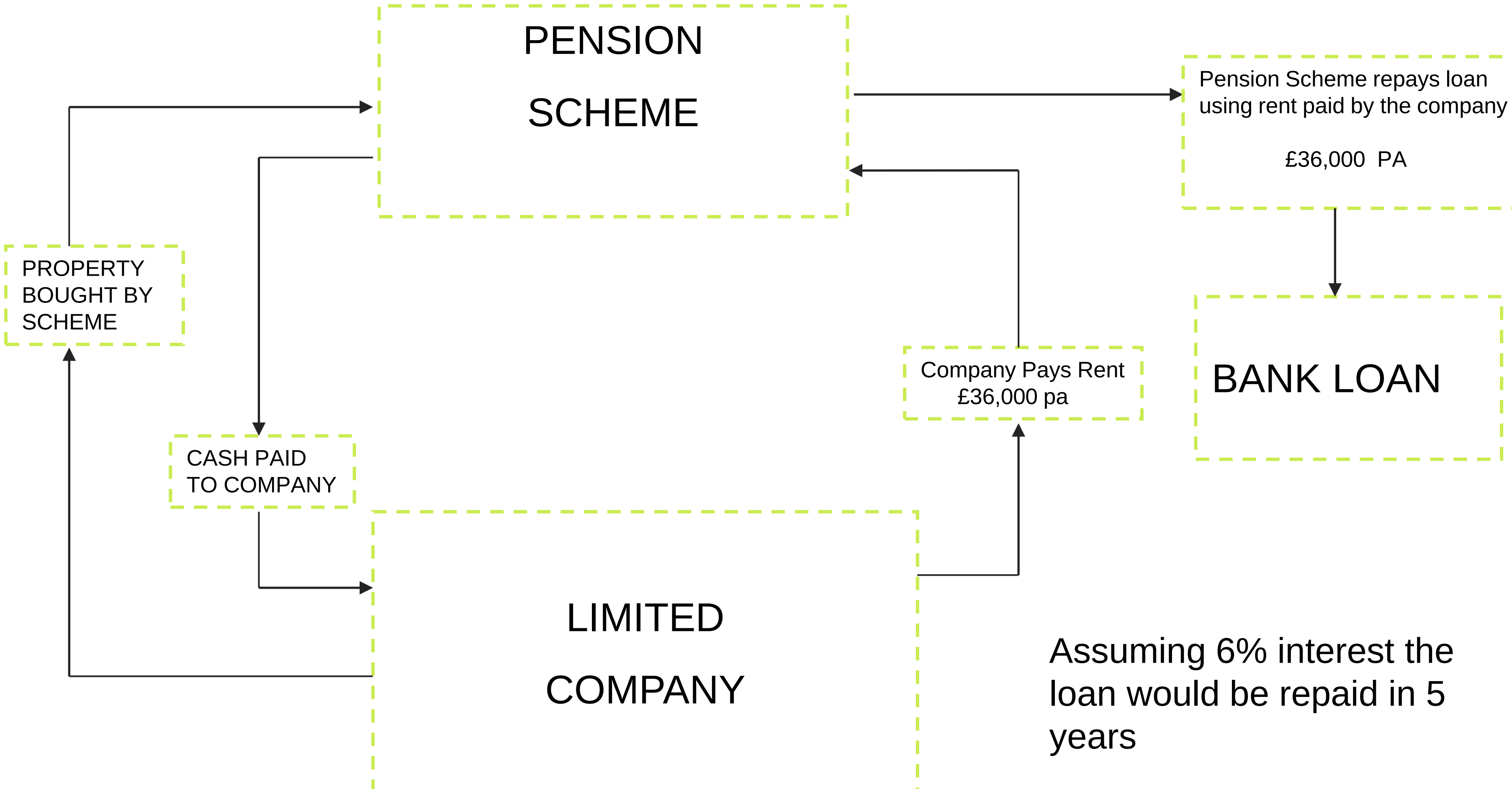
PENSION SCHEME

Pension scheme can borrow 50% of it's net asset value £300,000 / 2 = £150,000

BANK LOAN

Tony Medcalf
Tax Partner

Pre-sale planning opportunities - Use Pension Funds to Buy Building



Assuming 6% interest the loan would be repaid in 5 years

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Tax Partner

Pre-sale planning opportunities - release funds from pension

- Timing Can Impact on Tax Rate

    - Be mindful that currently corporation tax is at 19% rising to 25% post 1 April 2023.
    - Exchange and complete property purchase before increase in corporation tax rates.
    - Consider the timing of contributions, after 1 April 2023 attract corporation tax relief at 25%.
    - Those further contributions and rents can be used to repay bank debt.

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Tax Partner

Pre-sale planning opportunities - release funds from pension

- Summary
  - Upon completion the company would receive
    - » an increase of £256,500 in cash taking into account
    - » the £450,000 received
    - » Less £100,000 and £150,000 paid into scheme and
    - » The reduction of corporation tax payable of £19,000 and £37,500)
  - Brad and Angelina's pension funds have increased to £225,000 each.
  - The rental income is the same as the existing company pension contribution – no increase in cash flow commitment
  - Rental is treated as business expense and offset against profits – same as pension contributions

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Tax Partner

Cash

- Limit funds extracted from company - dividend v capital gains tax rates.
- Surplus cash in company usually added to the sale price on a cash free debt free basis.
- Consider protection of cash and surplus assets by imposition of holding company.
- Consider impact on BADR.
- Consider impact on IHT.

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Tax Partner

Questions?

James Kipping

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