

HM

Hall Morrice
Chartered Accountants



KEY GUIDE

Starting and selling a business

Introduction

COMPLEX ECONOMIC OUTLOOK

With Covid-19 restrictions currently largely lifted, starting a new business, particularly in bricks and mortar, may again be viable. The economic recovery is looking more positive, according to figures from Office of Budget Responsibility released with the autumn Budget in October. Although the furlough scheme has now ended and staff shortages and supply chain issues are ongoing, there was positive news in the Budget around reliefs on business rates and other measures. The degree of return to pre-Covid 19 levels of activity is mixed, so business plans will need to factor in this range of issues.

Another uncertainty is the long-term economic impact of the UK leaving the EU. Even though a UK-EU trade deal is in place, retaining tariff-free trade, initial indications are that this has led to higher costs and worker shortages. Business travellers to the EU also face extra requirements.

When it comes to selling a business, it doesn't matter whether you are developing a business idea to quickly cash in before starting all over again (the typical serial entrepreneur), planning a smart career move (with the successful sale of a self-started business looking very good on your resumé) or are in for the long haul – planning your exit strategy at an early stage will ensure you don't pay more tax than necessary. This might be just the time to do that planning.

Contents



STARTING A NEW BUSINESS

The essential planning and funding questions you should ask before you begin



SELLING YOUR BUSINESS

Ways to value your business, how you can choose to get paid and the tax planning consequences



WHICH BUSINESS ENTITY?

How do you decide between being a sole trader, incorporating as a company or starting a partnership?



WHAT A BUYER WILL BE LOOKING FOR

How you can prepare your business to make it more attractive to potential purchasers



Starting a new business

Some of the decisions and actions that you take when starting a business can have significant effects for some time. But with careful planning and good advice, starting your own business may prove to be one of the best steps you ever take. First you need to research and develop your business idea, and review the market for it. Market research can be as basic as asking your friends and colleagues what they think, or as sophisticated as employing a market research agency.

Your business plan

The next stage is to prepare a business plan. This should describe the business, its objectives, its strategies and its financial forecasts. Every business should have a business plan, but it is especially important at the beginning. A good plan is essential if your business needs external funding such as bank finance but, critically, it will also allow you to measure how well your business is doing once you start trading.

The financial projection is particularly important, because this will cover pricing and costs, sales and profit forecasts, how much capital you will need and projected cashflow statements for the first three to five years. If you start with insufficient capital, your business may be dead in the water before it even begins.

The initial financial projection will essentially be an educated guess without any track record to base it on, and its accuracy will depend on your research. One way to deal with the likely inaccuracy of the initial projection is to prepare best- and worst-case outcomes. Once you start your business, you should keep updating your financial projection and, because it will then be based on actual figures, it should become increasingly accurate.

Planning point

If feasible, test your product or services on a small scale by working part-time around your current employment before making a final decision.

Leaving the EU

Your business plan will have to take account of the impact of the UK having left the EU, not just for your own business, but also how potential suppliers and customers will be affected.

Imports and exports from/to the EU are now subject to more stringent conditions (although full British border controls will not be in place until January 2022), with possible delays at the border. Exporters of food and drink have been hit particularly hard, seeing a sharp decline in sales since the UK left the EU.

Although business meetings in the EU should not present a problem, you now need to comply with entry requirements if carrying out work.

Finance and grants

Despite its limitations, your financial projection should give you an idea about how much finance you will need. Having adequate finance is probably the biggest hurdle for many new businesses. The obvious starting point is your own savings (but be careful of the capital gains consequences, if cashing in investments) and loans from family and friends.

In some cases, a bank overdraft or business loan may be available, although remortgaging your home might be the only option. Other possibilities include commercial mortgages

(useful if you are buying business premises) and grants (available from various sources). You might also consider online financing such as peer-to-peer lending and crowdfunding.

Freelancers

The ability to work where and when you want has its attractions, but working freelance does require a lot of self-discipline. Holidays and sickness mean no income, so you must aim to earn a full year's income in the weeks when you do work. Income will also have to fund any private pension contributions you wish to make.

Planning point

Rather than running the business alone, consider the benefits of having a partner or bringing in a co-shareholder. It's a good way of obtaining complimentary skills – for example, you may be good at developing the business but lack sales, marketing or financial skills.

Which business entity?

Many start-ups are as a sole trader because this is the simplest, most flexible, business structure. Running your business as a sole trader can result in paying more tax compared to trading as a limited company, but the position is not as straightforward as it was a few years ago. This is because the basis of taxing company dividends has changed, making the withdrawal of profits from a company by way of dividends a much less attractive proposition. The extra 1.25% charge on dividends from 6 April 2022, and the increased rates of corporation tax coming in from 1 April 2023 (where a company's profits exceed £50,000) will further enhance the sole trader option.

EXAMPLE

Tax cost of different business structures

Samantha is currently self-employed, with annual profits of £80,000. For 2021/22, her total tax and national insurance contributions (NICs) will be £23,849. If she had instead run the business as a limited company – withdrawing £8,000 as director's remuneration, with the remaining profits taken as dividends – the tax cost could have been reduced to £21,574. The tax saving may not be considered sufficient compensation for losing the simplicity and cost savings of operating as a sole trader.

There are advantages and disadvantages to a limited company structure:

Advantages

It may be easier to raise finance.

In theory, a company offers personal protection from your business debts (this protection is reduced if you have to give personal guarantees).

It is much easier for your family, relatives and others to become involved in the running of the business as they can be made directors without you losing any control.

Some suppliers and lenders prefer to deal with a company.

Disadvantages

More administration.

Your financial statements are publicly available in an abbreviated form (less information is reported if your company qualifies as a micro-entity).



It can be better to start off as a sole trader or partnership and incorporate later if you expect your business to take a while to become profitable. This is because losses from a sole trader business or partnership can be offset against your other income for the previous three years. It is more difficult to change business structures in the opposite direction.

Transition to tax year basis for year end reporting

While unincorporated businesses are currently able to structure their year end tax payments on a tax year or a current year basis, from 2023/24 these businesses will be required to use the tax year basis only. HMRC plans a transitional year in 2023/24 where taxpayers will be able to off-set any overlap relief against the profits assessed in 2023/24 which may have formed when the business commenced. However, if you are setting up a business now, it makes sense to begin under the tax year reporting basis.

Off-payroll working

If you are a contractor and working for clients using a limited company structure, then you need to be aware of the tax implications if you fall foul of the off-payroll working (IR35) rules. The rules apply if you would be classed as an employee were you to be working directly for the client without the intervening company structure.

The responsibility for deciding whether the off-payroll working rules apply generally falls on the client. They effectively treat you as an employee for tax purposes if the rules apply – but with no entitlement to the rights and benefits that go with employment, such as holiday pay.

When it comes to premises and equipment

You want premises that enable you to operate effectively but without any unnecessary costs. You also need to consider the future – you don't want to be tied to premises that might be unsuitable when your business grows. The main choices are:

- working from home – maybe a spare room or a cabin in the garden;
- renting – this usually has minimum upfront costs but rent is a tax-deductible expense;
- buying outright or taking a long lease.

Whether you are renting, buying or leasing business premises, make sure you budget for all the related costs. Business rates can be a substantial cost, so make sure you apply for small business rate relief (in Scotland, the small business bonus scheme) if you qualify. For premises in England, 100% relief applies where the rateable value is less than £12,000. Additionally, as a result of the Covid-19 crisis, there is a 66% discount on business rates for retail, hospitality and leisure businesses in England from 1 July 2021 until 31 March 2022 (with 50% relief from 1 April 2022 until 31 March 2023 on rates bills up to £110,000 per business). There are additional specific measures for businesses during the crisis from the devolved governments in Scotland, Wales and Northern Ireland.

High overheads have resulted in many business failures and you must be careful if your business is seasonal – the costs will continue despite a reduced off-season income. The Covid-19 crisis has starkly illustrated this problem. Trading or working online (see below) should remove much of your overhead.

Tax relief for buying equipment is provided through the system of capital allowances. These give tax relief in the year of purchase or spread it over several years. There is an annual 3% write-off if you buy business premises where the construction contract was signed on or after 29 October 2018. For two years from 1 April 2021 to 31 March 2023, companies investing in qualifying new plant and machinery benefit from a 130% super-deduction. This means that for every £100 of expenditure, an allowance of £130 is available.

Registering for taxes

If you are in business as a sole trader or partnership, you will need to register with HM Revenue & Customs (HMRC) as soon as you start working for yourself. Paying NICs will entitle you to the state pension and some other benefits. HMRC is usually aware of new limited companies and should contact you.

Planning point

Consider leasing the equipment you need rather than buying it outright. Leasing can be more tax-efficient and leasing high-value items, such as cars, will be much healthier for your cash flow during the first few years of trading.



As a director, both you and your company will pay NICs on your remuneration from the company. Your contributions will entitle you to the state pension and contribution-based benefits, such as jobseeker's allowance. Your company's contributions will be reduced, maybe to nil, by the annual £4,000 employment allowance (although this is not available if you are the company's sole employee).

You must register for VAT if your sales exceed the registration threshold (£85,000 until 31 March 2024). Even if your turnover is below the threshold, if you register for VAT you can recover the VAT that you are charged on your purchases. There are special schemes for small businesses, such as cash accounting and the flat rate scheme, as well as schemes for retailers and some other types of business.

Planning for tax payments

Not setting enough aside for tax payments can catch out sole traders and partners, especially early on.

EXAMPLE Tax payments

You start self-employment on 6 April 2021, preparing your first accounts to 5 April 2022. The income tax and NICs for the whole year will be due on 31 January 2023, plus possibly another 50% payment on account for the following year.

A good approach is to save a regular amount to fund tax liabilities. It also helps to have your accounts prepared as soon after your year end as possible to give plenty of warning of future liabilities.

Employees

You might start off solo, but when your business grows you may need to employ staff. Employers must deduct tax and NICs from employees' pay under the Pay As You Earn (PAYE) system. You will have to register with HMRC as an employer and run payroll software that reports real time PAYE information to HMRC every pay day.

Other important staffing issues include training and improving staff performance, the national living wage (the national minimum wage applies to employees aged under 23 and apprentices), employee rights, health and safety, and the provision of a workplace pension into which your employees must be automatically enrolled.

Trading or working online

Trading or working online should reduce (or even eliminate) overheads as it can remove the need for expensive premises. For retailers, there are other advantages:

- Online marketplaces make it easy to set up a simple online shop and sell products straight away.



- There are fewer constraints to how large your business can grow.
- Your market can be expanded beyond local customers very quickly.
- There is a wide range of online marketing tactics which can be used to target new customers.
- It will be possible to stay open if there are any future Covid-19 restrictions and lockdowns.

Even if not fully digital, it is important for a new business to have an online presence. At the very least, this means having a website to promote and market your business.

SELLING YOUR BUSINESS

There are a variety of tax consequences to selling your business, depending 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 price is based on the future performance of your business - typically over a three- to five-year period - and you remain involved in the business to 'earn' the deferred proportion of the sale price.

Planning point

The reporting requirements can make running payroll quite difficult, especially if you are not altogether comfortable using a computer. Automatic enrolment can also be fairly challenging. You might therefore decide to outsource these functions, allowing you to remain focused on running your business.



If you are selling a company, 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.

Seller's preferences	Buyer's preferences
Paid in cash.	May, if the sale is to a company, offer shares or loan notes.
Sell the company itself.	Buy the business and its assets (a far simpler arrangement for the buyer. If they take over the company then they also take over any hidden liabilities).

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 from the disposal. You then have to extract the proceeds from the company, which can result in a double charge to tax.

Capital gains tax

The most important tax consideration is business asset disposal relief (formerly known as entrepreneurs' relief) as this reduces capital gains tax (CGT) to just 10%. With a higher rate of CGT of just 20%, the cost of not qualifying is not as onerous as it once was, but it is important that you meet the qualifying conditions for business asset disposal relief whenever possible:

Planning point

Establish whether or not business asset disposal relief is available well in advance of a sale. If your company has more than 20% of non-trading activities, income or assets, then it might not qualify as a trading company, but it may be possible to rectify this situation prior to the sale.

- If you run your business as a sole trader or as a partnership, business asset disposal relief will apply for any assets used for business purposes. You must have run the business for at least two years to qualify.
- If you run your business as a company, business asset disposal relief will be available provided the company is a trading company, a 5% shareholding test is met (relief will continue to be available, however, where a shareholding is diluted to less than 5% as a result of external investment), and you are an employee or director. The two-year rule applies to all three conditions.
- Relief may also be available for associated disposals. This is where you personally own assets which are used by your company, or by a partnership if you are a partner.

There is a lifetime limit of £1 million of qualifying gains, so this will cover most disposals. If the disposal (or some aspect of it) does not qualify for business asset disposal relief, then gains are taxed at the rate of 10% up to the level of your basic rate income tax band, and at 20% thereafter.

Calculating gains

Where you are disposing of a sole tradership, 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 is the difference between the total sale price and the value placed on the net assets of the business (assets minus 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 minus what you paid to buy or subscribe for the shares.

In a partnership, each partner owns a share of each of the business assets. Therefore, 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.

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. As mentioned above, 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.

Planning point

With an earn-out, you must 'earn' part of the purchase price based on the future performance of your business following the sale. Professional advice is especially important with this type of arrangement.

Should you accept 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.

Disadvantages of loan notes

Riskier than receiving cash. Securities can fall in value and unquoted shares can be very difficult to sell.

The possibility that the purchasing company will fail.

Advantages of loan notes

You will not have any immediate CGT liability because 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 (although in some cases you will lose the benefit of business asset disposal relief).

Whether you decide to accept securities will depend on your bargaining position (i.e. how desperate are you to sell) and whether the sale price is higher than that for a cash sale. 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 before it's sold.

Capital gains tax planning

It is important to take professional advice either at or before the start of the sale negotiations. This may let you make a deal that reduces the amount of gains liable to tax.

You can make use of your husband's/wife's or civil partner's annual CGT exempt amount by transferring assets to them before the sale. If the disposal (or some aspect of it) does not qualify for business asset disposal relief, you can also make use of your husband's/wife's or civil partner's basic rate income tax band so that gains are still taxed at 10% rather than 20%.



Reinvesting your gains in shares that qualify under the enterprise investment scheme (EIS) will defer your gain until the EIS shares are sold, while reinvesting in shares that qualify under the seed enterprise investment scheme (SEIS) will exempt a proportion of the gain. However, both types of investment are relatively high-risk.

Be warned that CGT could well see some changes over the next few years which are detrimental to business owners. CGT has been earmarked as an area for the Chancellor to raise tax revenues to restore the country's depleted finances.

Other tax implications

Selling your sole tradership 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. 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 you have claimed capital allowances on you may have a balancing allowance, reducing your taxable profit, or you may have a balancing charge, increasing it.

The VAT treatment depends on whether or not a business is sold as a going concern:

Going concern

No VAT to pay on the sale of the business. 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.

Not a going concern

VAT will be paid on those assets where you have claimed VAT back – stock, equipment, fixtures and fittings and possibly property.

There are no VAT consequences when a company's shares are sold because the underlying business will remain unchanged within the company.

WHAT A BUYER WILL BE LOOKING FOR

It helps if you know what a buyer is looking for and why they acquire businesses.

Buying a business has several advantages over 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 for a business with a proven track record, as many of the problems encountered with a start-up will already have been discovered and solved.

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 that 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. Of course, in some cases a buyer may simply want to remove you, as a competitor, from the marketplace.

Preparing your business for sale

Once you know what a buyer wants, you should consider how best to make your business saleable. This will include:

- Years of reasonable and consistent profitability – preferably showing growth (although the Covid-19 crisis may have had a negative impact here).
- Ensuring that contracts with suppliers and customers are in order.
- Securing assets such as intellectual property.
- Checking out any threats such as potential litigation.
- Making certain that 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 think, and the

last thing you want is employees or competitors becoming aware that your business is up for sale.

Setting the selling price will probably be the most difficult aspect of the sale. There are various models which 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.

Due diligence and warranties

Once the buyer has made an offer, you then must 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 performing, get an idea of what the future holds, and identify any issues or problems which might need warranting or indemnifying. A purchaser buys a company with all its actual and potential liabilities, so the buyer is likely to request a wide range of warranties and indemnities from you – although precisely what warranties and indemnities you give will form an important part of the negotiating process.

Planning point

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.

**HOW WE CAN HELP**

We help businesses from start-up, through growth and onto ultimate sale. We can advise you on the many issues you might encounter at any stage in the life of your business.

- When selling, we can help you negotiate the best deal, balancing price, risk and tax.
- We can keep you aware of changes in regulations affecting businesses, and smooth your dealings with HMRC.
- During times of crisis, such as the Covid-19 outbreak, we can help you navigate the support on offer.

Our aim is to help you steer clear of the hazards of business life, but provide expert help if you do encounter them. When you have spent your lifetime building your business, you deserve the best deal on its sale and the best advice to help you achieve it.

HM

Hall Morrice

Chartered Accountants



Hall Morrice Chartered Accountants

6&7 Queens Terrace
Aberdeen AB10 1XL

Tel 01224 647394

E-mail accounts@hall-morrice.co.uk

Web www.hall-morrice.co.uk

Partners

Shonagh L Fraser C.A.

Anne R Hall C.A.

Robert J C Bain C.A. C.T.A.

Derek J Mair F.C.C.A.

Directors

Stuart F Gordon F.C.C.A.

Derek J Petrie C.A.

Michael I Innes MCIBS

Hall Morrice LLP is a limited liability partnership registered in Scotland number SO303198 with its registered office at the above address. Registered to carry on audit work in the UK and regulated for a range of investment business activities by The Institute of Chartered Accountants of Scotland.