



WHITELAW WELLS  
CHARTERED ACCOUNTANTS

## CLIENT MEMORANDUM

### IS YOUR COMPANY READY FOR SALE?

Clients involved in the day-to-day management of companies they own seldom have the time to plan for the time when they will sell their shares. But such planning can be critical both in terms of the price obtained for their shares and the tax ultimately payable.

The purpose of this Memorandum is to encourage our clients who hold shares in unquoted companies to consider at an early stage the steps which can and should be taken to ensure that when shares change hands their price is maximised and any consequent tax incidence minimised. There is no substitute for a well considered, well implemented exit strategy.

#### THE SHAREHOLDER

The earlier planning starts the better. Ideally shareholders should be considering tax and operational matters five years before a sale is anticipated.

If the company has any surplus assets – for instance, investments or excessive cash – it may well be advisable to withdraw these from the company well in advance of the company sale. However, it is important to have regard to the tax implications of these withdrawals. If the company owns valuable trading premises, the shareholders may wish to buy these from the company at market value (possibly giving rise to a taxable gain in the company) and lease them back to the company on normal commercial terms. The shareholders may consider that ownership of the freehold will be a good investment for retirement.

If excessive cash in the company is withdrawn by way of increased remuneration or dividends, there may well be a diminution in the value of the shares, so that the core business will be more affordable for the buyers.

One of the reasons for planning five years in advance is that such radical restructuring of the company's Balance Sheet may distort the trading results in the short term. Corporation Tax may be payable on capital gains on disposals by the company, but this can often be offset by a trading loss, even if it arises from substantial pension contributions. The vendor wants to complete such radical reorganisation so that, subsequently, his or her company can demonstrate two or three consistent years of improving profits which is the ideal prelude to achieving an optimum price.

Selling shares in an unquoted company will probably be the single most important transaction in a shareholder's life. It makes sense to ensure, as far as possible, that the fruits of the investment are enjoyed by the investor rather than the Inland Revenue.

Some of the possible tax planning matters to consider:

- Taking advantage of provisions to defer or avoid or reduce the payment of capital gains tax. These include the attractive new entrepreneurs' relief. All require certain conditions to be fulfilled before full advantage can be taken of their benefits - careful planning allows the best utilisation of these reliefs.
- Ensuring that the shares held qualify as shares in a trading company to obtain the maximum level of relief.
- Establishing non-UK residence. It may be possible to avoid capital gains tax by living outside of the UK while still making regular visits.
- Paying a pre-sale dividend.
- Shares in a trading company often qualify for 100% Business Property Relief from Inheritance Tax. When the company is sold, the cash proceeds will be liable to Inheritance Tax. For the vendor who wishes to make provision for his family, it is usually preferable to make gifts well before the sale of the company: the values of gifted shares are usually lower and surviving the seven year Potentially Exempt Transfer period is more likely.
- Review pension funding arrangements whilst there is flexibility before the shares are sold. Ensure that any actuarial surpluses that arise on premature death enure for the benefit of the vendor's family and not the purchaser of the company. There is often a case for converting from a conventional occupational pension scheme to a personal pension format.
- Establishing or enhancing the funding of a self-administered pension scheme, which will reduce Corporation Tax liabilities before the sale: loan backs and investments in the employer company can help cashflow.
- On 6 April 2006, the rules relating to privately funded pension schemes changed radically. Directors and employees should have reviewed their position in the light of these changes. In addition, the Pensions Regulator now has considerable power to compel a company to make sure that its pension fund is adequately resourced. This issue needs careful consideration well in advance of a company sale, and it may be advisable to seek advance "clearance" from the Regulator.

## **THE COMPANY**

The old adage "first impressions make the greatest impact" is never truer than when a potential purchaser reviews the financial history of a target company. What is he looking for?

First and foremost, a business with a proven track record and the potential to grow. Key indicators will be:

- sales and earnings growth
- stable gross profit margins
- positive cashflows, ideally capable of sustaining operations, funding capital investment and providing a return to shareholders
- efficient working capital utilisation
- a viable balance sheet

How can you ensure that your company is the one which catches his eye?

- maximise profits and cashflows in the run-up period to sale by:
- managing trade debtors
- eliminating slow moving or obsolete stock (tighten purchasing criteria and review base stock levels)
- cancelling non-essential capital expenditure
- considering carefully all research and development expenditure
- whilst it is always important for a company to ensure that its plant and computer equipment is viable and can sustain effective competition, it is usually better not to initiate major investment immediately, or in the two or three years, before sale
- isolate or sell under-performing or non-income producing assets - these may include loss making subsidiaries or parts of the business or vacant land and buildings
- a safe and easily achievable means of improving profit in the short term, before sale, is to eliminate unnecessary cost or overhead

A key question owner managers should ask themselves is: “How is my business performing compared to my competitors?” Answering this question may well point to areas in which improvements can be made.

Bear in mind that the acquirer is purchasing the promise of future cashflows and in this context it might well be appropriate to review whether or not directors’ remuneration, including pension contributions, reflects commercial reality. Personal benefits for shareholders are best eliminated early so that profit is enhanced and the sale process is made easier. To give a better financial profile, distribution of profits by dividend may be the better alternative to funding lifestyles if a sale is envisaged.

Finally, the purchaser will require some indication of what the future holds. Clients contemplating the sale of a company are strongly advised to formalise their thoughts in this area, ideally in a formal plan covering the next two to three years, updated regularly for changing conditions. A

well-reasoned vision of the company's immediate future can be a very valuable asset when negotiating its sale.

### **A WORD OF WARNING**

At all costs owner managers should avoid the trap of allowing the process of selling the company to divert their attention from running the business. A customer or contract lost, production difficulties, or cashflow problems will probably reduce the price. Interesting as active involvement in the sales process may be, working shareholders may be best advised to employ specialists to guide them through the difficult days ahead, leaving them to concentrate on day to day management.

### **CONCLUSION**

Planning the optimum exit strategy for individual shareholders is a complex and time consuming exercise. Many issues must be addressed including the inter-action of the various taxes (capital gains tax, inheritance tax and income tax) and, most importantly, the aspirations of the individual shareholders.

We will be pleased to discuss your individual circumstances with a view to planning an optimum exit strategy.

### **FOR GENERAL INFORMATION ONLY**

Please note that this Memorandum is not intended to give specific technical advice and it should not be read as doing so. It is designed only to alert clients. Professional advice should always be sought before action is taken or refrained from.