Selling a business can be expensive, complicated and time-consuming, and may also have significant tax implications, so you need to plan carefully and get the right advice at an early stage.

Why sell?
There are many reasons for selling a business. For example, if you are selling as an individual (rather than through a company), you may wish to retire, or cash in your investment to provide a nest egg for the future or release funds for new investments. Alternatively, you may want to move out of a business area which is proving unprofitable; or sell certain assets to ease financial pressures on your other businesses; or the business may have become insolvent and have to be sold to pay off creditors.

Your intentions will affect the structure of the deal and the restrictions and potential liabilities you are willing to accept. For example, do you want to dispose of the business outright or are you willing to retain an interest in it or even take shares in the buyer’s company? Do you want to remain involved as an employee or consultant going forward? Are you planning to start a new business? If your new business is in a similar industry, you may have to delay starting it, as the buyer will probably want to restrict you from competing with the existing business immediately after the sale.

In addition, you will have to pay tax on the proceeds of the sale, so you will need advice on how to minimise your tax liability. You will also incur substantial expenses and professional fees, and may have to devote a lot of management time to the process - which can distract you from running the business during the process and could damage the business if the sale falls through. For all these reasons, you must get the right advice and do all you can to make the sale process as smooth and efficient as possible.

Shares or assets?
Assuming the business is operated through a company, there are two ways for the buyer to acquire it: by buying the shares in the company from its shareholders, or by buying the assets of the business from the company. There are several differences between the two:

Assets and liabilities: in a share sale, the company passes to the buyer, including all its assets and liabilities, but in an asset sale the buyer may try to “cherry pick” the assets it wants and leave all liabilities other than employees with the seller.

Form of transfer: shares are transferred by a simple stock transfer form, whereas different assets require different forms of transfers. For example, property requires a conveyance or assignment, and customer contracts need to be assigned or novated.

Consents and approvals: on an asset sale, the assets have to be actually transferred to the buyer and this may require the consent of third parties. For example, customer contracts may not be transferable without the consent of the customer, and the transfer of a leasehold property will require the consent of the landlord.

Stamp duty: if the company owns a valuable property, the buyer may prefer to buy the company, as it will only have to pay stamp duty at 0.5% of the purchase price, whereas if it buys the property, it will have to pay stamp duty land tax of up to 4% of the price of the property.

Tax: in a share sale, the company’s tax liability passes to the buyer, whereas on an asset sale the tax liabilities of the business normally remain with the seller. If the company has tax losses, the buyer may want to buy shares rather than assets, so it can set off the tax losses against profits in the buyer’s company. For the seller, on a share sale the price is paid directly to the individual shareholders, whereas on a sale of assets by a company the price is paid to the company and then, if the shareholders want to receive the money personally, the sale proceeds have to be transferred as a dividend.
from the company to the shareholders, which can only happen if the company has sufficient distributable reserves. This may trigger a double tax charge, first for the selling company and secondly for its shareholders, which can make an asset sale very unattractive for the seller.

Generally speaking, for the reasons given above, sellers prefer to sell shares whereas buyers tend to prefer to buy assets. The choice will depend on the parties’ respective bargaining strengths and the nature of the business.

**Tax issues**

On the sale of the business, the seller will have to pay tax, calculated by reference to the increase in the value of the shares or assets since the seller acquired them, subject to any tax reliefs or tax mitigation available to the seller.

There are various ways for a seller to mitigate this tax liability. The different methods of mitigation will depend on whether the seller is an individual or a corporate entity, and whether the sale is of shares or assets. Indeed, in an asset sale, a different tax treatment may apply to different types of assets. The rate of tax payable will in some cases depend on how long the seller has owned the shares or assets. The seller's tax liability may also be reduced by pre-sale restructuring (see “Getting started”) and can be mitigated or delayed by the seller taking shares in the buyer or loan notes from the buyer, rather than being paid the whole price in cash.

The tax issues arising on the sale cannot be covered in detail in this bulletin, but the potential tax liability may be considerable, so you must get the right advice from your solicitor or accountant at an early stage.

**Getting started**

Once you begin to think about selling, you need to get an idea of the value of the business and what price a buyer may be prepared to pay. Alternatively, if you have already received an offer, you need to decide if it is high enough. Sellers are often surprised at how much – or little – their business is worth. Your accountant can help with this, but you may also want to consult a valuer, broker or other business consultant.

**Finding a buyer:** most importantly, the sale obviously cannot happen unless you can find someone willing to buy the business. Often the buyer will be someone who has already dealt with the business - for example, a competitor, supplier or distributor. Alternatively, buyers can be found through personal contacts, brokers, advertisements in the trade press, or websites offering businesses for sale.

**Tax planning:** the next step is to consider the most tax-efficient structure for the sale, as discussed above. Aside from tax planning, you may need to prepare the business for sale. This preparation could involve anything from simply getting your paperwork in order to carrying out a full-scale restructuring of the business.

For example, if you are selling part of your business, you may want to transfer the assets of that part of the business into a new company and then to sell the shares in that company. Other pre-sale restructuring could include paying a dividend to remove cash from the company prior to sale, or capitalising an inter-group debt owed by the company to the selling parent to reduce the liabilities of the company. Alternatively, existing loan stock in the company may need to be converted into shares, and share options may need to be exercised to subscribe for shares, which will then be sold to the buyer - assuming that the sale price is higher than the conversion price of the loan stock and the exercise price of the options. Any pre-sale restructuring will need to be carefully planned in good time for the sale.

**Preparing your paperwork:** you should also anticipate that the buyer will carry out a detailed investigation of the business. Preparing for this exercise in advance can have two benefits: first, if you can deal with the buyer’s enquiries quickly and efficiently the business will appear more professional and well-organised; secondly, the more you prepare in advance, the less the sale process will distract you from running the business while you retain ownership. The buyer will probably want to carry out a brief investigation at the outset, to value the business and agree a price. The valuation will cover such things as premises, equipment, stock, debtors, creditors, and goodwill. Make sure you do not give the buyer any information about the business until it has agreed to keep the information confidential.

As a practical matter, don’t underestimate the amount of management time involved in the sale process. You will need to be able to effectively manage the business at the same time, just in case the sale falls through and you are left continuing to own the business.

**The legal process**

**Heads of agreement:** once the parties have agreed a deal in principle, they will often draw up heads of agreement (also known as heads of terms, an offer letter or a letter of intent). The heads are designed to identify the main issues (e.g. deal structure, price and time-table) and act as a “route map” for the rest of the transaction. They will be treated as legally binding unless stated otherwise so, if you do not want to be
committed to the deal until you have signed a formal sale agreement, the heads should state that they are not legally binding.

You may want some provisions to be legally binding - for example, before you give the buyer any information about the business, you will want the buyer to keep the information confidential and not use it to compete with the business if the sale does not proceed. You can also ask the buyer to pay a deposit which you can keep if the buyer pulls out of the deal, and to pay your costs if this happens - the buyer’s reaction will indicate whether the buyer really intends to go ahead with the deal. In turn, the buyer may want a period of exclusivity during which you must not negotiate to sell the business to anyone else and must pay the buyer’s costs if you do.

Whilst the heads are important, you should avoid spending too long on them - especially if they are not legally binding - as you can waste time and costs negotiating them. After the heads have been finalised, the buyer will carry out its investigation of the business and its solicitors will prepare the sale agreement (see below). If you can have your solicitors draft the agreement, this could help your negotiating position.

**Exchange and completion:** when the documents have been finalised, each party will sign the sale agreement and give its signed copy to the other party (“exchange of contracts”). On exchange, the parties will be committed to the deal. On completion, the buyer will pay the price and you will transfer the shares or assets. Exchange and completion may be simultaneous or the buyer may want a period in between - for example, to obtain any necessary consents from customers (as you may be reluctant to tell your customers about the sale until a formal sale has been agreed). As seller, you will also need to decide when to tell your employees about the sale – if you are selling assets, rather than shares, you have to formally consult with employees before completion, and you may not want to start this process until exchange of contracts.

The length of the process can vary considerably between transactions, but you should normally allow for at least six weeks from the signing of the heads of agreement until completion.

**Due diligence**

Once the parties have signed the heads of terms, the buyer will begin its detailed investigation of the business – the process called “due diligence”. Due diligence is designed to help the buyer to identify problems which need to be covered in the sale agreement, and any consents required for the transaction. Issues identified in due diligence may make the buyer want to renegotiate the price or even pull out of the deal altogether.

What will the buyer ask for? It will be interested in the trading position of the business (e.g. key contracts, debtors, creditors and capital commitments), onerous obligations (e.g. long-term contracts involving high payments) ownership and condition of assets (e.g. title to land, the terms of any leases, or the condition of stock), employees (e.g. employment terms, salary payments, pensions and other benefits), litigation (e.g. disputes with customers or claims by employees), taxation (e.g. tax arrears or disputes with the Revenue) and IT/intellectual property issues (e.g. computer contracts and the right to use software or trade marks).

Due diligence can be very time-consuming for the seller, particularly if the buyer insists on a detailed investigation, so it will help if you have organised your paperwork in advance.

**Share/business purchase agreement**

This is the most important document in the transaction, and most of your solicitors’ time will be spent in reviewing and negotiating it. It will set out the key commercial terms which have been agreed between the parties, including:

**Conditions:** if the sale is subject to any conditions - for example, obtaining the consent of a key customer to the transfer of its contract - these will be covered in the agreement and must be satisfied before the sale can complete.

**Price and payment:** the buyer normally pays the price in full on completion, but it may want to hold back part of the price until a later date (a “deferred payment”), make the price dependent upon the business achieving certain targets in the period after completion (an “earn-out”) and/or hold back part of the price in a joint account to use in settling any problems which arise after completion (a “retention”). You will need to decide whether to agree to this.

**Completion accounts:** the buyer may want the price to be dependent on the value of certain assets, such as stock, work in progress or debtors. These will be valued on completion using “completion accounts”, with the price being adjusted downwards or upwards if the value of the assets is lower or higher than the levels which the parties have agreed in advance.

**Apportionments:** on an asset sale, the parties will normally draw a line at completion, with the seller being responsible for all liabilities before completion, and the buyer responsible for those after completion. Pre-payments by or to the seller will also be divided pre- and post-
completion. For example, if you have already paid rent for a period after completion, the amount for the post-completion period will be added to the price the buyer will be paying, whereas if you have received a deposit from a customer for work to be done after completion, the deposit will be deducted from the price.

**Book debts:** The agreement will govern how book debts are collected after completion. In a share sale, the book debts are automatically inherited by the buyer but, in an asset sale, the buyer may not want to buy them (as it may not be able to collect them from customers after the sale), in which case you may have to keep them and collect them. Alternatively, the agreement may provide that the buyer will collect them on your behalf, as it may not want you contacting customers for a period after completion.

**Premises:** On a share sale, the buyer automatically takes on any premises owned by the company but, on an asset sale, the agreement must specifically deal with the transfer of the premises, including obtaining the landlord’s consent if the property is leasehold.

**Employees:** On a share sale, the employees remain with the company which the buyer is acquiring. On an asset sale, the end result is similar in practice, as the regulations known as “TUPE” provide that the employees’ contracts are transferred from the seller to the buyer on completion, so the employees become employed by the buyer. As seller, you cannot dismiss employees immediately before completion if they are surplus to the buyer’s requirements going forward, and you must consult with the employees about the sale.

**Restrictive covenants:** The buyer will want to restrict you from competing with the business, and taking customers or employees after the sale. If you are planning to continue running a separate business, or starting a new business, after completion, you will need to check the restrictions carefully to make sure they do not prevent you from doing so.

**Warranties, limitations and disclosure letter**

One of the main sections of the sale agreement deals with warranties and indemnities - the detailed statements which you will be asked to make about aspects of the business, such as trading, finance, assets, liabilities, employees, property, litigation and tax. The buyer will rely on these statements and if any of them turns out to be untrue and the buyer suffers loss as a result, then it can claim damages against you. You should therefore limit your liability: first, by negotiating the warranties so they only contain statements about the business which you are happy to give; secondly, by preventing claims above a specified limit (e.g. the price) or after a certain date (e.g. 1 year after completion); and thirdly, by preparing a “disclosure letter” which lists any exceptions to the warranties, so the buyer cannot claim damages for those matters.

The preparation of the disclosure letter can be time-consuming, but it can reduce your exposure under the warranties, so it is worth taking the trouble to go through the warranties and think carefully about what matters should be disclosed. In addition, all the information which you disclosed to the buyer in the due diligence exercise should be attached to the disclosure letter.

**Other major documents**

- **Tax deed:** On a share sale, the buyer inherits all tax liabilities of the company and may therefore ask for a specific indemnity against these - in the form of a tax deed or tax covenant. You should limit your liability under the tax deed, as discussed above.

- **Service contracts:** The buyer may also want individual sellers or key employees who are remaining with the business to sign new service contracts.

**After completion**

You must keep copies of the sale documents and the information which you supplied to the buyer during the sale process, as you will need to refer to these if the buyer brings a claim against you after completion.

**Note for buyers:** This bulletin is aimed at potential sellers. For an explanation of some of the issues affecting buyers, please read our bulletin entitled “Buying a business”.

**HOW WE CAN HELP**

RadcliffesLeBrasseur advises on all aspects of company and commercial law, including mergers and acquisitions, joint ventures, partnerships, banking and finance, private equity/venture capital, employment, intellectual property, commercial contracts, litigation and insolvency.

If you need advice on any of the issues mentioned in this bulletin, please contact Peter Coats (peter.coats@rlb-law.com), a partner in our Corporate Department.

Readers should take professional advice before taking any action based on this bulletin.