Sale and purchase of businesses and shares

Shares or assets?

If you are a sole trader or a partnership you can only sell assets.

If the business is being operated by a limited company, then the limited company can sell the assets, or the shareholders can sell their shares.

If you are trading through a limited company does it make a difference which route you adopt? Why would you choose one route over another?

A sale of assets is often the preferred route of the buyer. It will acquire a list of agreed assets. It does not take on any debts or liabilities and so can avoid the past baggage and any other risks that there may be. There may be a tax advantage for the buyer as well, as it may be able to amortise the purchase price, or part of it, against future profits and reduce its tax.

The difficulty with an asset purchase is that every contract has to be transferred to the buyer, and this can only be done, generally, with the agreement of the other side. So, for example, you need the consent of the landlord to take over the lease. Ever customer has, in theory, to agree to being transferred as, legally, the seller remains responsible to the customer. The difficulty becomes more profound with certain types of business, such as care homes, where a transfer will require a lengthy re-registration process.

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A share sale, on the other hand, means that ownership of the company changes, but all of the contracts which are in the name of the company are unaffected (there can be exceptions where there are “change of control” clauses, but these are relatively rare). It can be much quicker, therefore, to purchase shares. The lease stays in place, the registration with any regulatory authority may stay.

There can be tax advantages for the seller in selling shares as they may qualify for Entrepreneur’s relief which substantially reduces the tax liability. A sale of assets by the company can be costly for tax purposes. The money may be taxed on the way in to the company, and then taxed again on its way out. If you are a partnership or sole trader, don’t worry – if you are selling the whole of your business you may well be able to obtain the same Entrepreneur’s relief. Proper tax advice will be needed from your tax advisors. We will work with them to try to ensure that the deal is structured as they advise – subject, of course, to the other side agreeing!

The process

If you are selling assets you could expect to see a business sale/purchase agreement. This may well have anything from 10 – 50 pages. A share sale agreement may be even longer.

They will cover the basic provisions, such as who is selling, what they are selling, and the price/payment terms. There will be restrictions on future competition and there is likely to be a substantial section of warranties and indemnities – see below for more detail on these.

If you are selling shares there may also be a separate tax deed. This document is designed to ensure, in simple terms, that any tax arising prior to sale is paid by the seller and any tax afterwards is paid by the buyer. Of course it is not actually that

simple, and the tax deed may run to 20 pages on its own. See below for further comment.

If it is a sale of assets there will be ancillary documents designed to transfer the assets, or obtain third party consents, such as the landlord.

Whilst these documents are being negotiated the buyer is likely to be carrying out an investigation into the business. This is often known as “due diligence”. If incorrect information is supplied there could be claims against the seller. It is important that the exercise is taken seriously. Careless due diligence by a buyer may mean that it does not acquire what it expected to purchase. Slipshod answers by a seller may leave it exposed to claims or even prosecution.

Warranties and Indemnities

Warranties are statements about the business which is being acquired and they allow the buyer to come back to the seller for compensation if they are not correct. There may be 10 pages of them, or there could be 30-40 pages. They need not be frightening. Many of them will be purely factual and will give you no problem. Others may try looking forward, for indications of future profits. These should be resisted or qualified.

There should be limits on the seller’s liability under these warranties and indemnities. Normally they would be limited in time (i.e the time within which claims must be made) and as to the amount that the buyer can claim. After all, you would not want to sell the business for £1 million and be sued for £2 million.

As well as the limits on liability, it is normal to prepare a disclosure letter. This is a list of statements which qualify the warranties. They provide the buyer with information about circumstances where the warranty is not true. A buyer cannot sue if he has been told about the breach. However, it may be that he will seek to re-negotiate the price.

Indemnities are slightly different. They are used where there are specific circumstances which are of concern to the buyer, but where the seller is comfortable that there are no problems. So, for example, a seller may have employed a family member in the business who is not transferring. The buyer wants to know that there will be no employment claims. The seller may be quite comfortable that this family member will not claim, so will happily agree to cover any claims that may be made.

The warranties and indemnities, any limits on them, and the terms of any disclosures have to be negotiated between the seller and the buyer.

Tax Deed

As noted earlier, this is a supposedly simple principle, but can be very complicated once set down in writing.

The problems can arise where tax reliefs have been used by the seller that could affect the buyer in the future, and where the buyer may get the benefit of reliefs that relate to the seller’s prior trading which the seller could not use. Each side will want the use of these reliefs to be fair.

The deed must also deal with the procedure for dealing with any claims, or any investigations or agreements with the Revenue. The buyer will want control as it may

affect not only the business purchased but the whole group. The seller, on the other hand, does not want the buyer to have a free hand at the cost of the seller.

How can we help?

Nigel has been involved in the sale and purchase of businesses and shares for more than twenty-five years. He can advise on the negotiations, any heads of terms, the sale/purchase agreement and the tax deed. We can assist you with the due diligence exercise.

We will seek to ensure that, as seller, you do not accept unreasonable liability, and that you understand the price, the payment terms and the warranties that you are giving. If you are buying, we want an agreement that gets you the business you expect and the protection from the warranties that is reasonable.

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