CHARTERED
ACCOUNTANTS

KEY GUIDE

Starting and selling a business

Introduction

COMPLEX ECONOMIC OUTLOOK

Anyone contemplating starting a new business, especially a bricks and mortar one, needs to factor in current economic conditions. The UK might just avoid recession in 2024, and inflation has now fallen to 3.9% (November 2023). However, consumer spending is being curtailed due to higher costs of living, and unemployment is expected to increase during 2024. Many self-employed businesses, in particular, are struggling to cope with higher costs, and their take home pay is not rising in line with inflation.

Energy costs are still high, and the government's current support package running until 31 March 2024 is far less generous than the support package it replaced; some businesses are no longer receiving any help at all. The situation is far from ideal for a new business which will want to plan at least two or three years ahead.

Your plans will also need to factor in inflation, which – while now much lower – is still above its 2% target, increased borrowing costs, higher salary expectations plus staffing shortages.

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.

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Starting a new business

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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

The current economic situation has increased the level of risk and volatility faced by businesses, meaning financial projections are unlikely to be anywhere near 100% accurate. Adopting a "what if" approach can help. Scenarios such as *"what if my raw material cost rises 10% more than expected?", or "what if I cannot attract enough staff and instead have to pay for high levels of overtime?"* can be built in to your risk management planning.

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, with possible delays at the border. A just-in-time supply chain model may therefore no longer be feasible. 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 (be warned that the cost of remortgaging is significantly higher than a few years ago). Other possibilities include commercial mortgages (useful if you are buying business premises) and grants (available from various sources).

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.

EXAMPLE
Tax cost of different business structures

Samantha is currently self-employed, with annual profits of £80,000. For 2023/24, her total tax and national insurance contributions (NICs) will be £23,599. 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 marginally reduced to £23,401. The insignificant tax saving would almost certainly not be considered sufficient compensation for losing the simplicity and cost savings of operating as a sole trader.

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.

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 higher rates of corporation tax which came in from 1 April 2023 (where a company's profits exceed £50,000) have further enhanced the sole trader option.

There are advantages and disadvantages to a limited company structure:

Advantages	Disadvantages
It may be easier to raise finance.	More administration.
In theory, a company offers personal protection from your business debts (this protection is reduced if you have to give personal guarantees).	Your financial statements are publicly available in an abbreviated form (less information is reported if your company qualifies as a micro-entity, although this is set to change).
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.	

Credit: iStock/cdl-creative-studio

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.

Previously, unincorporated businesses were able to benefit from a significant delay before having to pay tax on profits if they opted for an accounting date early in the tax year. However, from 2024/25, all unincorporated businesses will have to use a tax year basis (2023/24 being the year of transition), so this advantage has been lost.

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, there is a 75% discount on business rates for retail, hospitality and leisure businesses in England and Wales for 2023/24, subject to a cash cap of £110,000 per business (this relief will continue for 2024/25). There is no equivalent relief for retail, hospitality and leisure businesses situated in Scotland or Northern Ireland (although 100% relief is going to be introduced for hospitality businesses situated on the Scottish islands).

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 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 either give full tax relief (effectively expensing the cost of equipment) 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.

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.

Credit: iStock/targovcom

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.

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 £5,000 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 2026). 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.

Making Tax Digital
Making Tax Digital (MTD) for VAT is now compulsory for virtually all VAT registered businesses, so they have to keep digital records and use MTD-compliant software to directly submit VAT returns to HMRC.

Businesses which become VAT registered must enter the MTD regime immediately upon registration. This obligation should be borne in mind when purchasing accounting systems for your business.

MTD for businesses and landlords is now not due to come into effect until 6 April 2026.

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

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.

EXAMPLE
Tax payments

You start self-employment on 6 April 2023, preparing your first accounts to 5 April 2024. The income tax and NICs for the whole year will be due on 31 January 2025, plus possibly another 50% payment on account for the following year.

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, although 21- and 22-year-olds will qualify for the national living wage from 1 April 2024) employee rights, health and safety, and the provision of a workplace pension into which your employees must be automatically enrolled.

Workplace pensions
The cost of contributing to a workplace pension is something that is easily overlooked when budgeting the costs of running a new business, and the administrative side can be quite time consuming, especially if there is frequent staff turnover or where staff pay fluctuates from month to month. You will have pension obligations even if there are just one or two employees.

The rules are quite detailed, but very basically you will need to classify your employees into three categories depending on earnings and age:

- **Eligible jobholders** are those employees aged between 22 and the state pension age who earn more than £833 per month (£10,000 annually). You automatically have to enrol these employees into your workplace pension scheme.

- **Non-eligible jobholders** are those employees aged between 16 and 74 that have qualifying earnings, but who do not qualify as eligible jobholders. They are not eligible for automatic enrolment, but can choose to opt in to your workplace pension scheme.

- **Entitled workers** are those employees aged between 16 and 74 who do not have qualifying earnings. They are entitled to join a pension scheme, but there is no requirement for you to make any contributions on their behalf.

Several pension providers offer suitable workplace pension schemes for small employers. One low-risk option is the National Employment Savings Trust (NEST). This is a low-cost scheme established by the government to ensure all employers have access to a pension provider.

The definition of earnings is based on total pay, including any commissions, bonuses, overtime, statutory sick pay or statutory maternity, paternity or adoption pay. Contributions are calculated on earnings between £520 (the lower level of qualifying earnings) and £4,189 per month (between £6,240 and £50,270 annually). The minimum contribution rate is 8%, of which you, as the employer, must contribute at least 3%.

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 should be possible to stay open regardless of any restrictions or lockdowns as long as you have the resources.

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.

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.

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.

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 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:

- 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.

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.

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.

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	Advantages of loan notes
Riskier than receiving cash. Securities can fall in value and unquoted shares can be very difficult to sell.	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.
The possibility that the purchasing company will fail.	You may be able to make use of several years' annual CGT exempt amounts (although the value of the exempt amount is now just £6,000 (£3,000 from 2024/25), plus 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.

Other tax implications
Selling your sole tradership could affect your income tax position for the year of disposal since your income might be lower due to not having a full year's profits.

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	Not a 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.	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.


Credit: iStock/ChiccoDodiFC

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.

Planning point

Although you might be looking forward to retirement, or just a long break from running a business, a buyer may be prepared to pay more if you stay on for a fixed period as an employee or consultant – especially if you have been a key part of the business's success.

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 pandemic and continuing economic problems 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.

Credit: iStock/Fodor90

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. Current government rules are subject to change, so we can keep you up to date with legislative developments and your commitments under any new regulations.

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.

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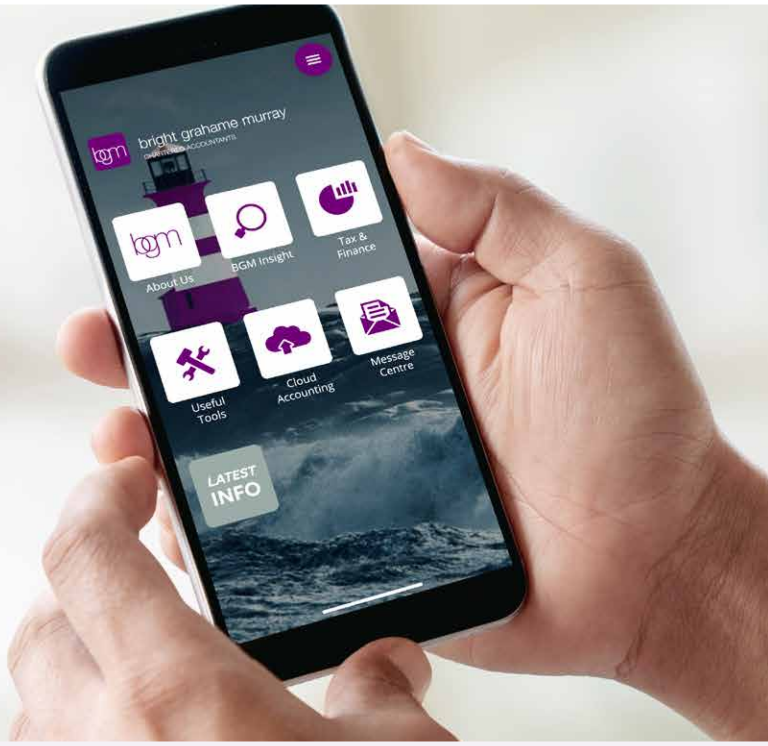

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