



Buying and selling a family business – commercial, tax and legal issues

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Howard Hackney

Howard escaped from Grant Thornton UK LLP in 2008 where he had been a partner for over 25 years to establish his own boutique practice. During his time at Grant Thornton he was head of professional practices for the North West and head of family businesses for the UK. At Grant Thornton he had a variety of roles including office Managing Partner, North West regional marketing partner and membership of the partners appointments panel. Howard specialises in advising mid market professional practices and family businesses. In 2002 he won the CBI's national award as "Best Business Adviser".

Howard's current focus is providing "special projects" advice to family businesses with turnovers up to £30m and professional firms with up to 20 partners. His experience extends from first generation to eighth generation family businesses with all the succession issues that involves.



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Martin Dawson, director Aquarius Tax Consultancy Limited. Martin was previously a tax partner at both Baker Tilly and Grant Thornton UK LLP where he provided bespoke tax advice to owner managed businesses and high net worth individuals. Aquarius was set up in January 2010 to provide similar advice to both their own individual clients and those of smaller accounting firms that they work closely with. Aquarius have particular expertise in dealing with foreign domiciled clients (“non-doms”) and those with UK property issues.

Current projects include the restructure of several family companies (including the image right company of a well-known sportsman!), all with HMRC advanced clearance, securing significant tax savings on future value extracted. The company are also currently advising on the purchase and ownership restructure of various high value properties in London to avoid the annual ATED charge and ensure future CGT and IHT liabilities are minimised for their non-dom owners.



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Agenda

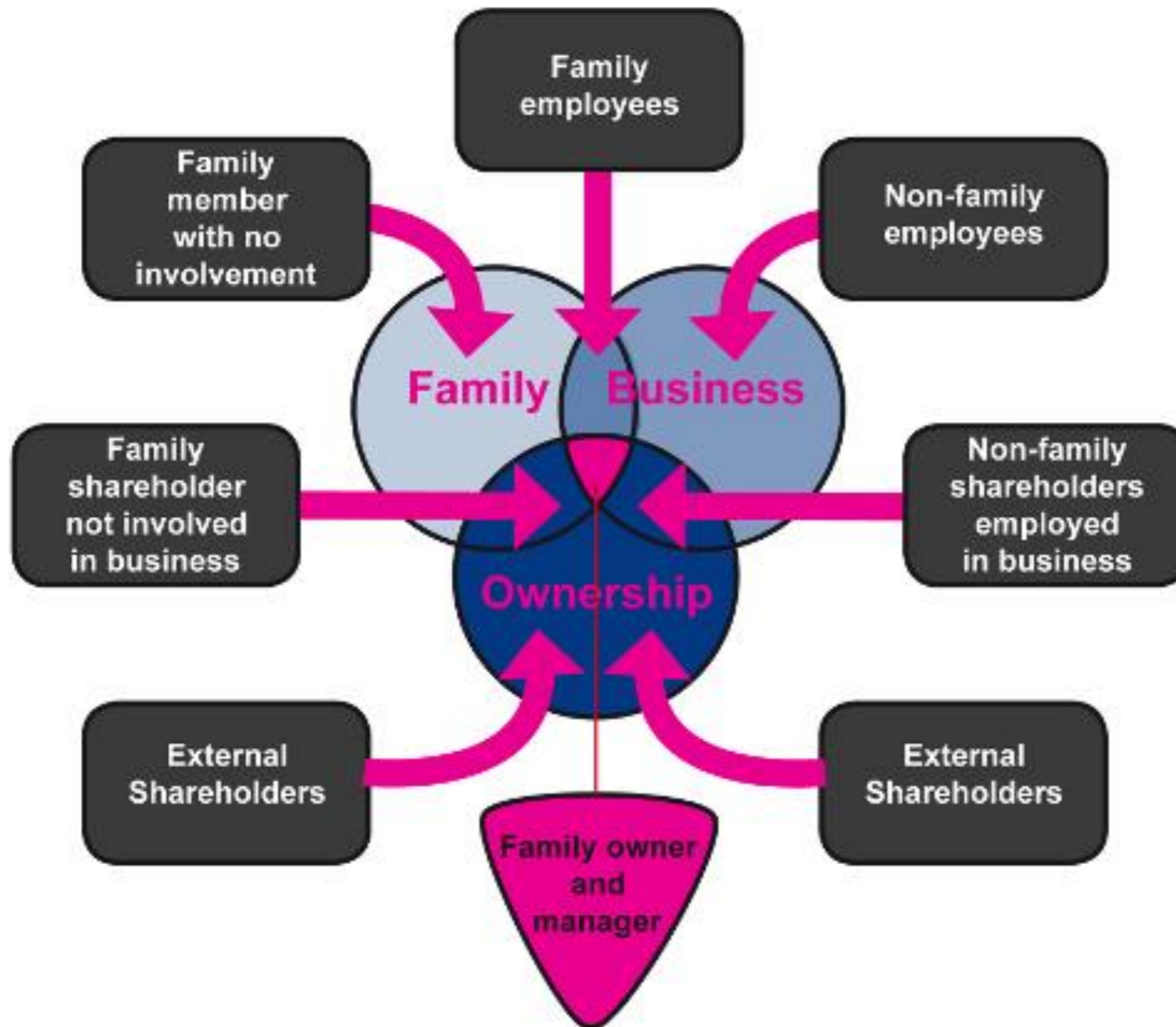
- Initial decision
 - The process
 - The negotiation
 - The advisers
 - Tax issues
-
- Focus – selling a family business





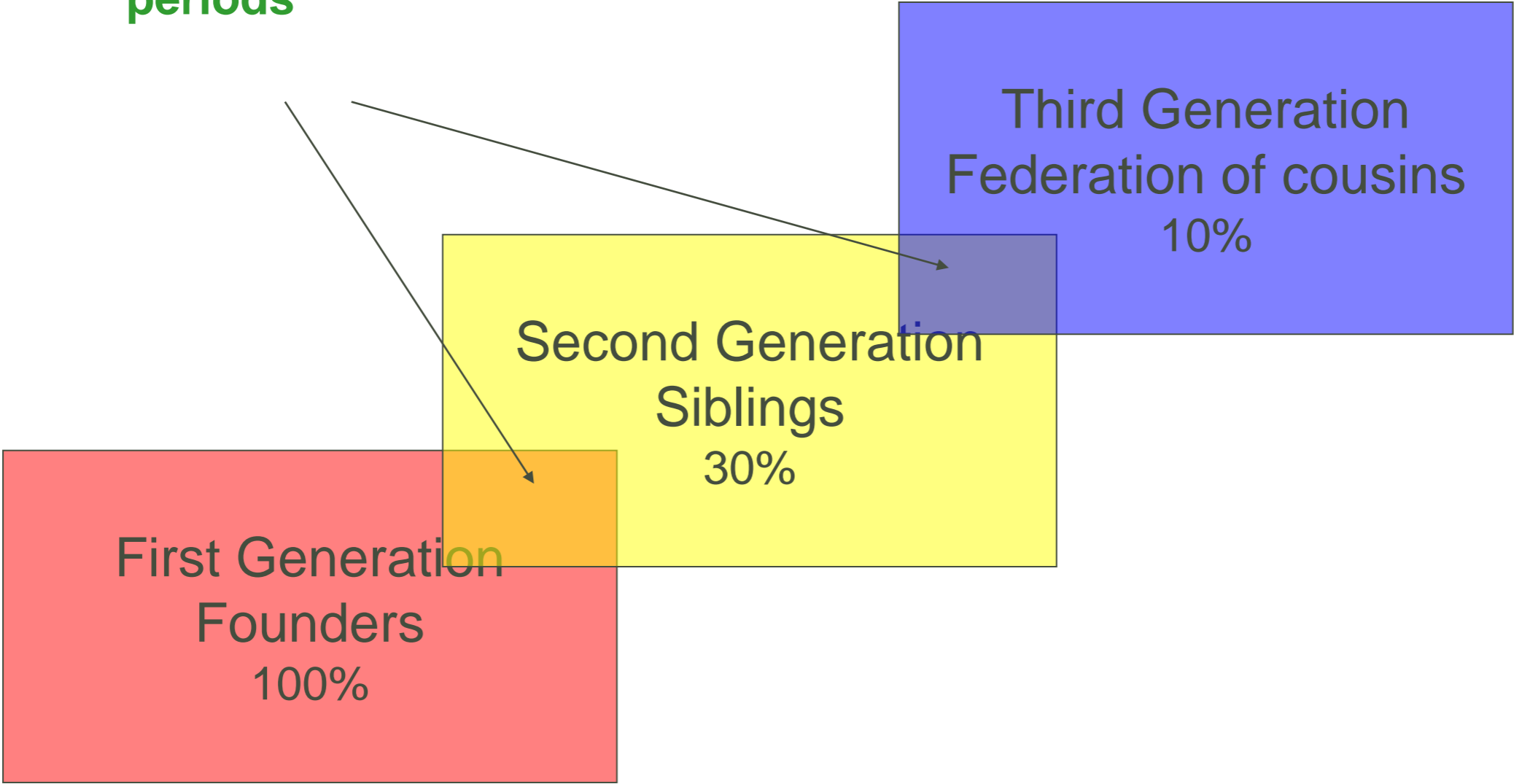
Initial decision

The potential for conflict within the family business



Transition

Transitional periods



Factors in the decision to sell

- The family dynamic
- Strategic position – Porter’s five forces, Boston Matrix etc
- Availability of management (not shareholding) succession
- Family financial security without the business
- Market conditions
- Likely price



What does 2 + 2 make?

- Ask an accountant – what do you want it to make?!
- “Art not a science”
- Worth what a buyer will pay
- Wide variations not unusual
- Deals often driven by financial need



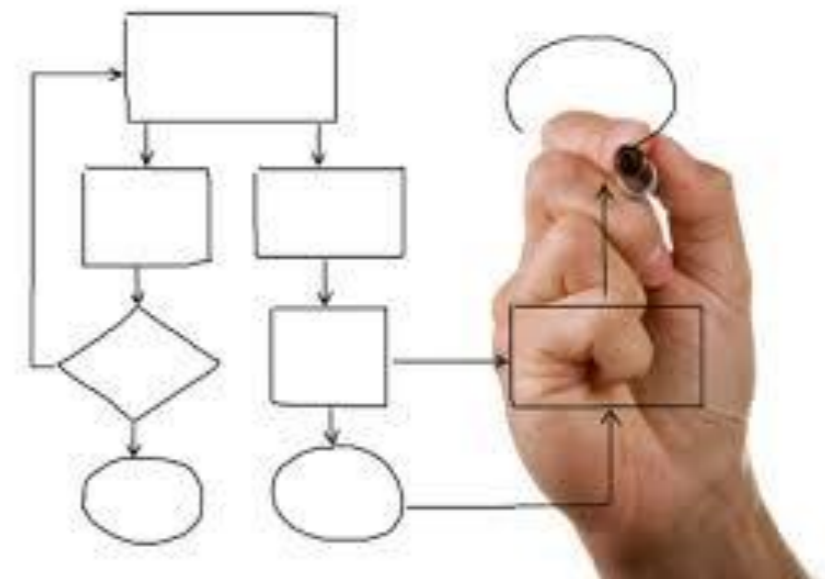
Methodologies

- Net assets
 - By far the easiest
 - Adjust for market values
 - Other liabilities e.g. dilapidations, redundancy, close down costs
 - Discounts will apply
- Earnings
 - Maintainable profits X multiplier
 - Goodwill = value less net assets
 - Variables
 - Maintainable profits
 - Exceptional items
 - Management reward
 - Weighting
 - Tax
 - Multiplier? 3-8 typically
 - Suggest others are unreliable



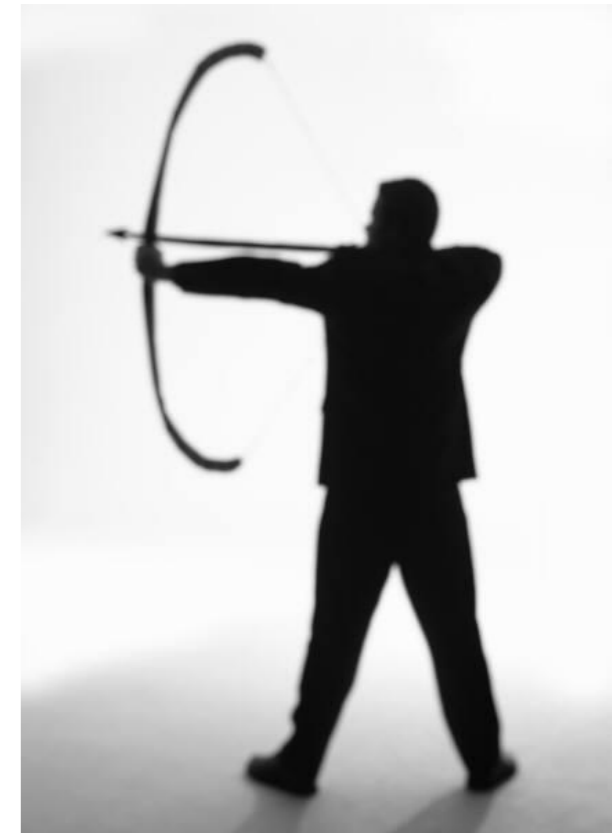


The process



Identifying targets

- Confidentiality important - Blanket approach dangerous
- Use the “lead adviser”
- Jointly you will know the likely acquirers - only one needed
- Perhaps a dozen at first stage → 2 or 3 at final stage
- Criteria
 - Products & services
 - Geography
 - Financial strength



The IM

- A sales document
- “Paint the picture” with adjusted results but be upfront with problems
- MUST be available before going to market
- Aids assessment of market value
- Establishes negotiating strengths and weaknesses
- Second guess question from targets
- What you want to know about them
- Do NOT indicate expected price
- Remember best value does not always = best price



The process – stage 1 to indicative offers

- Initial confidential approach by lead adviser
- Taster - elicit interest & with process & timetable
- NDA – and informal agreement to limited circulation of IM
- Issue numbered hard copy of IM – not by email
- Meet targets – genuine two way exchange
- Indicative offers



The process – stage 2 to formal agreement

- Assess offers
- Clarify & negotiate (2 week window perhaps)
- Identify preferred party
- Non binding HoTs with binding exclusivity period
- Mutual DD – defined scope
- Final negotiation & formal agreement
- If more than 9 months probably “dead”





The negotiation



Deal structure

- Largely tax driven – assets or shares
- Consideration
 - Cash
 - Deferred – loan notes
 - Shares
 - Earn out
- Strength of acquirer will influence acceptability
- Do not expect earn out to produce anything & shares to drop in value
- Basis of earn out? Sales or profit & how achievable
- Completion balance sheet – can be a big issue
 - Often nil cash/debt deal
 - With working capital adjustment



Other considerations

- Deal breakers
 - Identify at outset and scope for negotiation
 - Address at outset
 - Be unemotional – lead advisor can help
- DD
 - Will be used to “chip” the price
 - Often after HoT’s signed and emotionally committed
 - Potential use of data room
- Expect “game playing”
- Understand and recognise the other side’s perspective



Documentation

- It's simple isn't it!! – oh no it isn't
- SPA the basic document
- A “cast of thousands” if care not taken
 - Company
 - Employment
 - Property
 - IP
 - AND from each side!
- Service agreement if continuing employment
- Loan note agreement
- Non compete covenants
- Share sale lock ins





The advisers



Lead adviser

- Create a market via the process – but?? → creates value
- Initial indicative values
- Identified deal breakers early on
- Prepare Information Memorandum (IM)
- Identifying targets
- Manage the process
- Independence
- Make confidential approaches
- Create credibility in the process
- Can “play hard ball” – but also resolve deal breakers



Lawyers and others

- Lawyers
 - Experience crucial
 - Lead partner identified
 - Clear brief & fee quote
 - Challenge and 2nd guess but NOT to reinvent the deal
 - Potentially a beauty parade
- Others
 - Depends on the deal and complexity
 - Due Diligence (DD)
 - On vendor - normal
 - Seller on buyer – do not overlook
 - Vendor DD
 - Need for clear focussed instructions





Tax issues



Tax issues

- Share sale or asset sale?
- Structure of consideration
- Entrepreneur's relief – key points
- Pre-sale tax planning points/strategies



Share sale or asset sale – asset sale

- First principle
 - Seller prefers shares
 - Buyer prefers assets
- Consideration allocation important
- Corporation tax on goodwill
- Sale should constitute a TOGC for VAT purposes
- Liquidate to secure Entrepreneur's relief
 - costs of liquidation
 - is timing important?
 - Retained assets?



Share sale or asset sale – share sale

- Understand the deal - what is being sold/retained?
- Understand the consideration (next slide)?
- Are tax Clearances required?
- Entrepreneur's relief considerations (later slide)



Structure of consideration

- An obvious point but....consideration should be allocated pro-rata to shareholdings (re: Gray's Timber)
- Wholly cash and/or Loan Notes
- Deferred consideration – ascertainable/unascertainable?
- For Loan Notes, need to consider:
 - Type (QCB or Non QCB)
 - Tax Elections (s.169Q/R)
- For Earn Outs, need to consider:
 - Type (QCB or Non QCB)
 - Tax Elections
- Are Tax Clearances required (s.684/s.135)?



Entrepreneur's relief – key points

- Must own more than 5% of ordinary share capital
- Working employee or director
- 12 month test
- Consider non-statutory clearance if any uncertainty?
- EMI share option holders
- “funny” shareholders
 - trusts/non working spouses
- Non business assets
 - excess cash/investment portfolios



Pre sale tax planning points/strategies

- Pre sale dividends – worthwhile?
- Corporate reconstruction – may be too late?
- Exercising EMI share options
 - Entrepreneurs relief?
 - watch dilution effect on shareholders
- Going non resident – is it realistic?
- Intending to trade again – be careful of “anti-phoenixing” rules?



Other issues

- IHT planning
 - Cash & loan notes do not obtain BPR
 - Use of trust or PET's pre sale
- Sale of subsidiary
 - Substantial shareholding relief
 - Reconstruct or reorganise pre sale
- Need to look at deal from the other's perspective
 - Tax savings on purchase
 - Tax savings on sale
 - Split the difference and both have lower price





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