



## Acquisition of Shares or Assets



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## Preliminary

Whenever the owner of a business carried on through a company decides to sell, an initial question will need to be answered: is the sale going to be of the shares in the company that owns that business or will it just be the business assets themselves? The seller and buyer may well have very different views.

Frequently the question will be driven by tax considerations of the buyer and seller. However, there may also be a whole series of legal and administrative considerations.

## Taxation Considerations of Seller

Those who sell shares in a company may be liable to pay Capital Gains Tax at rates of up to 28%. Often, though, individuals who own shares in a company may be entitled to *entrepreneur's relief* from Capital Gains Tax. If they are entitled to that relief they will only pay tax at 10% on the first £10m of lifetime gains and will first be entitled to an annual CGT allowance (currently £10,600). Further gains will be taxable at the rates of either 18% or 28% depending upon total taxable income and gains.

Entrepreneur's relief will apply if the selling shareholder, being a director or employee of the company for not less than one year, holds at the time of sale at least 5% of the issued ordinary share capital of the company which is required to be a trading company or the holding company of a trading group.

Suppose instead the assets of the company are sold and the proceeds of sale are paid out to the shareholders? The first point to note is that there may be a tax charge to be met in the company on the difference between the tax base cost and the selling price of the assets. Often a sale transaction will put a valuation on goodwill where there is no tax base cost and this becomes liable to tax. The same could be true with a sale of a freehold property. For small companies making profits of £300,000 or less the disposal of goodwill could trigger a tax liability of 20% (or an effective marginal rate of 26% for profits between £300,000 and £1,500,000).

The proceeds of sale must then be paid out to the shareholders. This could be done by a formal liquidation within 3 years of the sale. Alternatively the HM Revenue & Customs concession for company dissolutions could apply without the cost of a liquidation (HMRC Extra Statutory Concession C16 (ESC C16)). Here the company must satisfy HMRC that it intends to cease trading and seek or accept a striking off by Companies House

Following this process, the proceeds of the sale should qualify for the 10% rate under entrepreneur's relief. If the sale proceeds were simply paid out by dividend the higher rate taxpayer would be liable to 32.5% income tax.

As from 1 March 2012, legislative effect will be given to ESCC16, However this legislation will limit to £25,000 the amount of a distribution that can be treated as capital and so potentially subject to tax at just 10% applying entrepreneur's relief. The new procedure for reductions of capital may be useful instead. Failing that a formal liquidation will be needed which is unlikely to cost less than £5,000 in professional fees.

Professional advice should be taken from advisers on the availability of entrepreneur's relief and ESCC16. An informal clearance as to the availability of ESCC16 is available from HM Revenue & Customs.

From the above analysis it will be apparent that the sellers of business assets could have a double hit to tax: the sales proceeds could be taxable both in the company and to them personally. This might mean a higher price being required for an asset deal compared with a share deal.

## Taxation Considerations for Buyer

Since April 2002 a buyer of intangible assets (such as goodwill) has been able to claim tax relief on the expenditure. The tax relief is secured by writing off the price paid for the asset and claiming tax relief on that write-off or *amortisation*. The write-off should be over the expected useful economic life of the user but not exceeding 20 years.

If the consideration includes a significant element for goodwill or other intangibles such as trade marks and know-how then there could be considerable scope for the buyer to claim tax relief on the costs of purchase. It may be possible to argue for a short economic life of an intangible asset like goodwill.

So a significant tax saving on the value of the intangible assets included in a transaction could be obtained.

The buyer of shares in a company must pay 0.5% stamp duty. If the assets to be bought include real property stamp duty land tax of up to 5% may be payable on the value of the property.

## Non Tax Considerations

Where goodwill values are low there may be only a modest potential tax saving for the buyer in the asset purchase route rather than the share purchase route. What are the other considerations?

### 1. Risk

The first and most important issue is the risk associated with buying shares rather than assets. With an asset deal the only liability that may be inherited unwittingly by the buyer is employee liabilities under the Transfer of Undertakings (Protection of Employment) Regulations 2006.

A buyer of shares buys a company "warts and all". There could be significant and unknown and unquantifiable liabilities. Often the biggest worry will be over tax liabilities. For contracting companies there might also be considerable uninsured risks on past contracts. There could also be product liability risks for defective or dangerous products. There could be uninsured claims in negligence.

A buyer can seek to protect itself through suitable warranties and indemnities from the seller. However these will not protect against the insolvency of the seller, his disappearance overseas or a liability which is discovered after the warranty period has elapsed. The management time and professional costs of dealing

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with unexpected liabilities should also not be underestimated.

The professional costs of due diligence and legal costs in drawing up the legal contracts for a share sale may be prohibitive. Very often for smaller transactions (certainly if the consideration is less than £100,000 to £500,000) an asset rather than a share deal may be necessary simply in terms of professional costs.

## 2. Third Party Consents

A contrary factor may be the need to secure third party consents for an asset deal but which are not required for a share purchase.

Asset sales must often be made on the basis of obtaining the consent of a landlord of leasehold premises

occupied by the seller. This may lead to requests for personal guarantees from directors of the buying company or rent deposits. In contrast it is unusual for leases to allow a landlord to terminate the lease on a change of control of the company.

There may be sensitive or important trading agreements with suppliers or customers which will need to be renegotiated on an asset sale. In small business sales however this is rarely a practical concern since even important contracts are rarely long term and are often quite informal.

## 3. Administration

A company sale can be achieved with a one page stock transfer form and delivery of a share certificate. In practice a lengthy share sale agreement

is negotiated to protect the buyer. The point, though, is that all assets and contracts transfer without formality.

With an asset purchase there may be considerable work for the buyer in dealing with the transfer of assets and contracts.

Even quite small businesses may have a multiplicity of assets (e.g. numerous domain names) and contracts (e.g. hosting agreements, rental, lease purchase agreements and supply agreements). The process of transferring these and apportioning liabilities between buyer and seller may be administratively burdensome.

## 4. Other Issues

The target company may have brought forward tax losses which could be utilised thus providing for a future tax saving on profits. (But note there are anti-avoidance provisions which can lead to the cancellation of losses on a change of control if the business is changed materially.)

Sometimes a company purchase brings the added benefit of a credit history and rating. These may be important particularly to suppliers dependent on credit insurance.

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