Selling your business: A good housekeeping guide

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Checklist: Selling your business

Set out in this guide are some of the key issues you should consider when preparing your business for sale. The sale process can be lengthy, complex and expensive. It is therefore important to minimise these costs and the taxation liabilities involved and make the sale as efficient as possible.

1. Statutory books and company law matters

Where the shares in a company are being sold, proof of ownership of those shares will be required by the buyer. The register of members in the company's statutory books (which must be kept up to date) is prima facie evidence of the legal ownership of the shares. Legal ownership will often also be evidenced by share certificates in the names of the relevant shareholders and it is essential to ensure that they are consistent with the register of members.

Certain statutory registers are required to be maintained by the company. These include:

- the register of directors/company secretaries;
- the register of members;
- the register of mortgages and charges created prior to 6 April 2013; and
- the register of people with significant control.

A company is also obliged under the Companies Act 2006 to file certain statutory forms with Companies House in respect of (amongst other things) its constitution, share capital, director(s) and company secretary, people with significant control, registered office and charges. Each company must also file its annual accounts and an annual confirmation statement.

It is prudent to carry out a review to ensure compliance with these statutory obligations prior to a sale of shares, which could avoid potential indemnities being sought from the sellers.

Sellers should also be aware of company law issues such as the laws relating to transactions with directors and the payment of dividends. Legal advice should be sought prior to the sellers or the company taking any steps in connection with a proposed sale.

2. Accounting and other records

A buyer will usually instruct accountants to prepare a financial due diligence report on the business being acquired. The accountants will therefore need to be given access to the financial and other accounting records, as well as the auditors'/accountants' working papers.

This will be an important step for a prospective buyer in deciding whether or not to pursue the acquisition and, if so, the proposed terms. These records must be kept up to date and must be accurate and detailed in order that the buyer's accountants are able to prepare a full report on the business as quickly and easily as possible.

General and specific warranties and indemnities are usually required by the buyer from the sellers regarding accounting, trading and (where the shares in a company are being sold) tax matters. Such warranties would usually relate to the latest annual accounts and the management accounts prepared since the end of the last accounting period. It is advisable to prepare the management accounts (so far as practicable) on a similar basis to the annual accounts, using the applicable accounting standards.

3. Restructuring

If it is proposed to sell only part of the business, or one or more companies from a group of companies, consideration must be given to the most tax efficient structure. A review of the current group structure should be undertaken. This would typically include dealing with dormant subsidiaries and overseas subsidiaries, arranging for assets and dormant companies to be transferred and companies to be struck off the register of companies.

The timing of such reorganisations is crucial. They must be carried out before the marketing for the sale or negotiations with any buyer are commenced, otherwise anti-avoidance tax law is likely to negate any tax advantages sought.

Tax advice must be sought prior to any reorganisation to determine the most tax efficient structure and to ensure that there will be no unforeseen tax liabilities. The tax base cost of the subsidiary or part of the business to be sold could be increased to its market value in appropriate circumstances, at the time of the reorganisation, in a tax neutral manner. Therefore, the gain for tax purposes on the sale would be limited only to the amount by which the consideration exceeds such market value.

There are also a number of corporate law issues that need to be considered when a reorganisation takes place.

Any reorganisation will need to be structured to ensure that there is no unlawful distribution by a company of assets to its shareholders. It is important that appropriate advice is sought before any such restructuring is carried out and that any distribution of assets is properly documented.

4. Due diligence

A thorough legal due diligence process will always be undertaken by the buyer on the target to establish the legal risks relating to the proposed acquisition and whether the proposed purchase price is justifiable. It is advisable for sellers to initiate their own internal due diligence review of the business to pre-empt any issues and maximise value.

This should include:

- Checking that all trading, business and other arrangements with third parties are (where possible) in writing, and all contracts are signed and dated and any amendments or variations are documented and formalised.
- Reviewing the obligations and liabilities of the business under the contracts and arrangements made with third parties, including any warranties and indemnities that have been given to such third parties, assessing how onerous those obligations are and the potential scope of any liability that may arise pursuant to such warranties and indemnities.
- Checking the properties owned and/or occupied by the business, ensuring that there is good title to these properties and identifying any related obligations (for example, repair obligations under leases).
- Ensuring that there is clear evidence of title for all key intellectual property used by the business including ownership of patents, copyright, design rights and trademarks or secure licences to use.

- Checking all contractual arrangements, consents and permits for any change of control provisions (or non-assignment provisions where the transaction is a sale of assets) to determine if a third party can prematurely terminate, vary or amend such arrangements on the sale of the business or on short notice.
- Compiling a list of the assets and liabilities (including contingent liabilities) of the business and collating the documentation to support these.
- Ensuring that consents, licences and permits needed for the business have been obtained and are up to date.
- Ensuring the conduct of the business and other activities are in compliance with all applicable laws, for example health and safety, environmental, data protection and employment law.
- Checking all internal procedures and policies are documented and up to date.
- Ensuring that copies of all insurance policies are available, confirming that all premiums have been paid and compiling details or copies of any recent, pending and anticipated claims.
- Collating details of any recent, pending or anticipated litigation relating to the company (where applicable), the business or the employees.

- Collating details of the bankers, all bank and similar trade and finance facilities and accounts, any debt securities issued by the company (where applicable), all liens, mortgages and charges on any property, all guarantees and indemnities given by or in respect of the business and all loans made by or to the business.
- Obtaining releases from lenders of any securities and charges that have been repaid and making appropriate filings.
- Identifying any customer complaints, known problems or potential pitfalls relating to the business.
- Ensuring that the company (where applicable) and the business have complied with all obligations under applicable tax legislation.

Where a purchase price has been agreed in principle, the buyer may still use the due diligence process to identify risk areas and use these to negotiate a reduction in the price prior to sale or by seeking to claw back that price post-sale by relying on warranties and indemnities. The sellers' disclosure process is designed to help to resolve any such issues and should serve to protect them from claims post-sale.

5. Confidentiality agreement

Any buyer (who may currently or prospectively be a competitor of the business) will want to undertake an investigation of the business, during which it will obtain confidential information. The unauthorised use or disclosure of such confidential information by the buyer could have a damaging effect on the business and it is therefore advisable to put in place a confidentiality agreement between the sellers, the company (where applicable) and any potential buyer to try to prevent the unauthorised use or disclosure of confidential information by the buyer prior to the sale completing.

6. Employees

If the sellers are contemplating a disposal of shares in a company, then the buyer will acquire the established contractual relationships between the company and its employees. All rights, duties and liabilities owed by or to the employees will continue to be owed by or to that company and the buyer will inherit all of these rights, duties and liabilities.

A buyer of shares in a company has no automatic rights of recourse against the sellers for the employment liabilities it acquires with ownership of the company. As a result a detailed investigation by the buyer is vital, as are the appropriate contractual provisions, which will enable the rights and liabilities to be apportioned appropriately.

In order to assess its liability in relation to employees, a buyer will usually request detailed information on:

- the key employees;
- the terms and conditions on which employees are contracted;
- the nature and size of the workforce;
- payroll costs;
- accumulated liability for redundancies/dismissals;
- whether there are any outstanding claims against the company from existing or former employees; and
- whether the company has complied with existing legislation.

Sellers should note the legal requirements for contractual arrangements and should check the company's existing arrangements to ensure that they comply. They should ensure that the documentation with employees is up to date and complies with appropriate legislation before the sale process begins. Under the Employment Rights Act 1996, every employee must be given a written statement of his or her terms and conditions of work by no later than two months after the commencement of his or her employment. The written statement must include details of:

- the name of the employer and employee;
- the date on which the employment began;
- the scale or rate of salary, or the method of calculating salary;
- the intervals at which salary is paid (for example, weekly or monthly);

- any terms and conditions relating to hours of work (including any terms and conditions relating to normal working hours);
- any terms and conditions relating to:
  - (a) entitlement to holidays, including public holidays and holiday pay;
  - (b) incapacity for work due to sickness or injury, including any provisions for sick pay; and
  - (c) pensions and pension schemes;
- the length of notice that the employee is obliged to give and is entitled to receive to terminate his or her contract of employment;
- the title of the job that the employee is employed to do or a brief description of the work for which the employee is employed;
- where the employment is not intended to be permanent, the period for which it is expected to continue or, if it is for a fixed term, the date when it is to end;
- either the place of work or, where the employee is required or permitted to work at various places, an indication of that and of the employer's address;
- any collective agreements that directly affect the terms and conditions of the employment, including the people with whom they were made where the employer is not a party;
- where the employee is required to work outside the UK for more than a month, certain further particulars concerning that period, the currency of remuneration, any additional remuneration and benefits as well as any terms and conditions relating to return; and

- a note stating whether a contracting-out certificate is in force for pension purposes for the particular employment concerned. Such a certificate is issued where there is an occupational pension scheme in place that satisfies certain conditions.

The particulars should also contain a note specifying any disciplinary rules applicable to the employee (or referring to a document that is reasonably accessible to the employee) and that specifies by description or otherwise:

- a person to whom the employee can apply if he or she is dissatisfied with any disciplinary decision relating to him or her;
- a person to whom the employee can apply for the purpose of seeking redress of any grievance relating to his or her employment and the manner in which any such application should be made; and
- where there are further steps to be taken in any such application, explaining those steps.

The terms should also deal specifically with intellectual property created by the employee and ensure that the company owns the intellectual property that he or she creates that is relevant to the business or is created during his or her duties or working hours.

An employee is entitled to receive an itemised statement of pay and deductions with his or her wages or salary. With an asset sale, it is usual to provide for employees' remuneration for the month in which completion takes place to be apportioned between the sellers and the buyer. Sellers should therefore be prepared to discuss the items that will be apportioned between the parties.

A change of ownership is usually an unsettling time for employees and there is always a risk that some employees may choose to resign, rather than continue working after the sale. Sellers can seek to retain their key staff by changing their terms and conditions of employment by, for example, using long term fixed contracts or enhanced notice periods.

A buyer will also want to be sure that the company has complied with the employment laws including those relating to sex, race, disability, age, religious belief and sexual orientation discrimination, the national minimum wage, fixed term and part time employees, health and safety and trade union activities, as well as the Working Time Regulations 1998 (as amended).

Sellers should check any liabilities or potential liabilities in relation to these matters to ascertain what claims are pending or could be threatened by current or former employees. This will enable the sellers to pre-empt the nature of the warranties and indemnities that they are most likely to be asked to provide.

With regards to a disposal of all or part of the assets of a business, rather than the shares in a company, the rights of employees working with those assets prior to the transfer, and the obligations and liabilities relating to those employees, will transfer to the buyer under the Transfer of Undertakings (Protection of Employment) Regulations 2006 (as amended) (TUPE). TUPE deals with a wide variety of further issues that sellers must bear in mind in addition to those that usually apply on a share sale (including an obligation to inform and consult with employees) and this area is highly complex.

7. Employee incentives

If sellers wish to incentivise the company's key employees to achieve a sale or flotation and want the employees to participate in the consideration received on the sale of a company tax efficiently, a variety of share option and share based schemes may be used. Sellers, however, should exercise caution as the overall rate of tax in the absence of appropriate advance planning could be extremely high.

It is crucial that a scheme which is tax efficient and meets commercial objectives is chosen and implemented as early as possible prior to the sale of the sellers' company. Schemes for giving incentives to senior employees can pay very well in terms of the consideration achieved on the sale.

Key personnel of small and medium sized businesses are often engaged as consultants either directly or through their service companies and such arrangements are normally put in place to exploit tax advantages. However, over recent years, anti-avoidance tax legislation has been introduced which, if applicable, could result in substantial adverse tax consequences for the business.

Buyers tend to treat such arrangements with caution and could seek unlimited indemnities for protection and, in more serious cases, withhold a part or the whole of the consideration as security to meet such liabilities. To avoid such arrangements becoming a major obstacle to completing the sale, they should be carefully considered well before the company or business is marketed for sale or negotiations with any buyer are commenced so that, to the extent appropriate, they can be refined or HM Revenue & Customs rulings can be obtained.

8. Pensions

An understanding of any pension arrangements in place is likely to be required by the buyer, as these may result in significant liabilities for it, particularly if they are underfunded or arrangements that are not approved by HM Revenue & Customs.

Traditionally, when selling the shares in a company, the buyer will require pension warranties, the most important of which would state that the pension schemes are fully funded (if final salary) or that all contributions have been made (if money purchase). Other warranties would refer to statutory requirements having been complied with.

If the company does not have any pension scheme established at all, it may be breaking the law, as all employees are entitled, as a minimum, to be offered access to an auto enrolment pension scheme. Failure to offer access to such a scheme, in the absence of any other, may result in a fine.

9. Intellectual property, information technology and data protection

A buyer will want to identify the intellectual property (IP) and information technology (IT) of the business and ensure that it is clearly owned, that it does not infringe the rights of any third party and, conversely, that it is not being infringed by any third party.

An important part of the due diligence exercise will therefore involve the scrutiny by the buyer of the business IP and IT. The extent of the IP and IT due diligence will depend on the nature of the business being sold and the relevance of IP and IT to the business. The sellers must therefore identify the areas that the buyer is likely to focus on and prepare for a thorough investigation. Such matters should include:

- compiling a list of all IP (whether registered, applied for or unregistered) to include trade mark registrations, inventions and patents, domain name registrations, design right, logos, trading names and copyright, databases, bespoke software, or any other intellectual property rights or similar rights or registrations;
- compiling a list of all key IT including hardware, software and bespoke software;
- ensuring all licences of software are valid and sufficient for the business, e.g. in terms of number of users;

- ensuring that all patent and trade mark certificates are available (as there will be an obligation to hand over the evidence of title on completion);
- ensuring that any registered IP that is to be included in the sale has not expired. Checks should also be made as to how long it is before the registered IP is due to expire or require renewal;
- checking that no IP has been licensed or assigned to another party (or, where it has been licensed or assigned, there are copies of the relevant documentation);
- ensuring that all domain name registrations are registered in the name of the company (where applicable) or the seller with the relevant internet registration body (such as Nominet), and, if possible, having all registration certificates available, including the renewal or expiry dates;
- collating details of any challenges made by a third party in respect of all the registerable IP rights, such as trade mark registrations, patents, registered design rights and any claims that any such IP infringes the rights of another;
- collating details of any licences that the business has granted to, or received from, third parties, whether the licences are written or oral, informal or formal, and details of any disputes or issues relating to such licences;
- collating documents relating to any known or alleged infringement of the business IP by a third party and the steps the business has taken;

- where the shares in a company are being sold, identifying any key IT or IP licences in the business agreements that have 'change of control' provisions that will be triggered on completion of the sale; and
- ensuring that the company (where appliable) or the seller is registered pursuant to data protection legislation, if required, and that its activities comply with the registration and relevant data protection legislation. Failure to comply with data protection law can be a criminal as well as a civil offence.

10. Conclusion

In summary, it is advisable to plan and prepare for the sale of a business well in advance. Such planning will have many advantages, which include saving tax, reducing risks, saving time and costs and creating the right impression to potential buyers.

This paper is designed to provide a summary of the issues addressed and set out some "good housekeeping" guidelines to prepare a business for sale. It is not intended as a detailed commentary on the relevant law. No action should be taken without first obtaining specific legal advice.

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