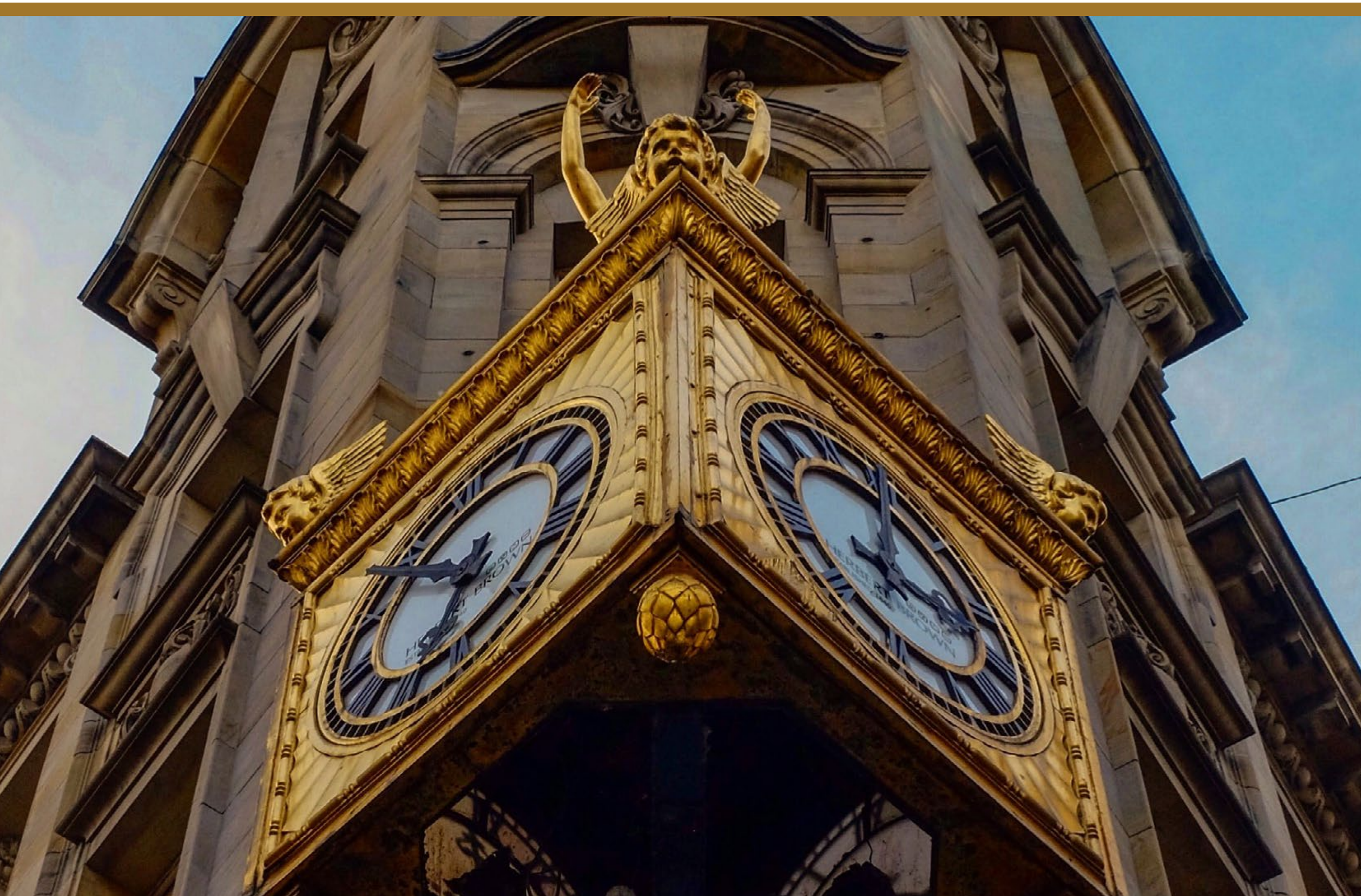
The Wealth Office



Planning to sell your business? Why only having an exit strategy isn't enough

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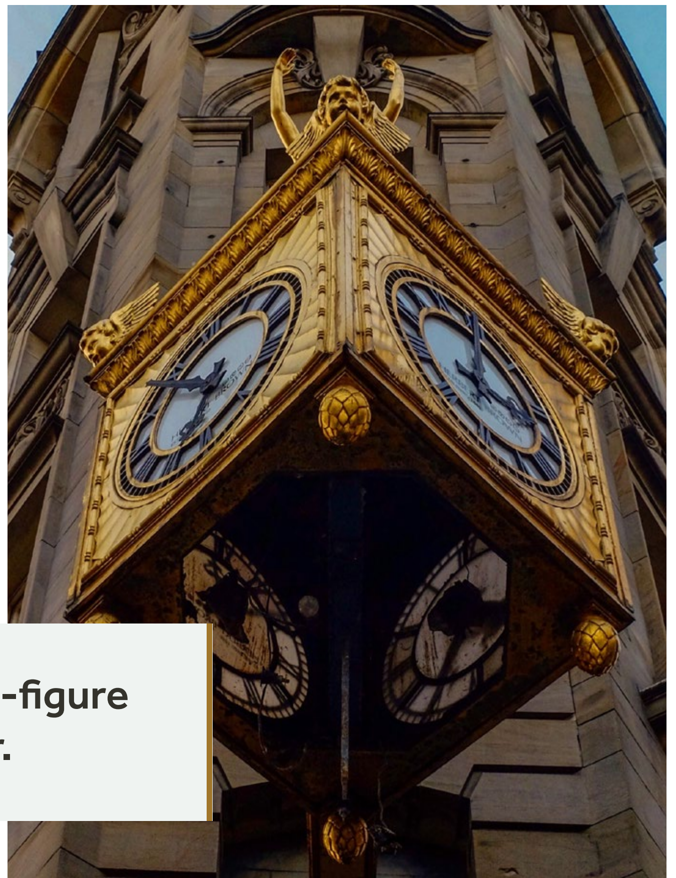
INTRODUCTION

It may have been in the planning for years - you're going to sell up and enjoy the hard-earned fruits of your labour. You have your exit strategy mapped out; you've identified your potential buyers, got the accounts in order and made sure it will run like a well-oiled machine without you.

But, before you even consider marketing the sale, there's a vital element that is often overlooked.

You must have a robust personal financial plan - pre and post-sale!

The benefits of financial planning are well documented; a recent study by Vanguard found that advised investors hit 80% of their financial goals. But, why is having a financial plan so important for business owners?



When you're likely to receive a seven-figure sum upon exit, there's a lot to plan for.

STRUCTURING YOUR PRE-SALE INCOME

We all have personal tax-efficient allowances and reliefs. You need to think carefully about the best way of utilising them long before the business is sold.

Rather than exceeding tax thresholds, assuming your partner is an employee or shareholder, you can equalise your salary and dividend income with them. It's an entirely legitimate way of taking an income for your family, as long as their contribution to the business is appropriate with their income.

As a reminder, Income Tax bands and rates for 2020/21 are:

	SCOTLAND		ENGLAND, WALES & NI	
Band	Taxable Income	Rate	Taxable Income	Rate
Personal Allowance	up to £12,500	0%	up to £12,500	0%
Starter Rate	£12,501 to £14,585	19%	-	-
Basic Rate	£14,586 to £25,158	20%	£12,501 to £50,000	20%
Intermediate Rate	£25,159 to £43,430	21%	-	-
Higher Rate	£43,431 to £150,000	41%	£50,001 to £150,000	40%
Top / Additional Rate	over £150,000	46%	over £150,000	45%

It's worth considering that your £12,500 Personal Allowance will be reduced by £1 for every £2 you earn over £100,000 in the UK - meaning that if you earn £125,000 or more you won't receive it at all. Then, for dividend income:

- The tax-free dividend allowance is £2,000
- Basic-rate taxpayers pay 7.5%
- Higher-rate taxpayers pay 32.5%
- Additional-rate taxpayers pay 38.1%

PENSION PLANNING?

Next, it's a good idea to top up your pensions. That might sound odd given that the sale of your business is likely to be your 'pension', but if you are trading as a limited company, pensions are an incredibly tax-efficient way to withdraw cash from your business pre-sale, for you and potentially your spouse. Remember, don't overlook the use of your spouse's basic rate tax band in retirement, rather than adding to your higher rate tax liability.

Employer pension contributions are treated as an allowable business expense, which will help offset corporation tax. You also won't pay National Insurance on them. If you also make employee contributions, they are free of Income Tax.

When paying into pensions there are two allowances:

- The Lifetime Allowance of £1,073,100, which is the maximum value your pensions can be without triggering a tax charge when you take income or turn 75.
- The Annual Allowance, which is equivalent to your relevant earnings (not including dividend income), up to a maximum of £40,000. This is the most you can contribute in your pension each year and receive tax relief. However, for high earners, this is tapered. If you earn more than £240,000 then your Annual Allowance may be reduced by £1 for every £2 of income over. This means that if you earn £312,000 or more, your annual allowance may be reduced to a minimum of £4,000.

You can make use of any Annual Allowance that you have used during the three previous tax years, provided that you were a member of a registered pension scheme. This could mean the company can contribute as much as £160,000 in one year, if you were not subject to tapering and had made no previous contributions.

You can make unrestricted withdraws from your pension from age 55. Typically, the first 25% is tax-free and you'll pay Income Tax on the remainder. How you spend your pension savings has become a lot more flexible since Pension Freedom reforms in 2015. They are also exempt from Inheritance Tax (so it might be wise to spend them last!)

Finally, pension contributions will also help reduce Capital Gains Tax when you come to sell.

CORPORATION TAX

Put simply, it's a tax on the profits of an incorporated business.

The current rate is 19%

REDUCING TAX ON THE SALE

Another effective way to reduce Capital Gains Tax (CGT) on the sale of your business is by using Entrepreneurs' relief.

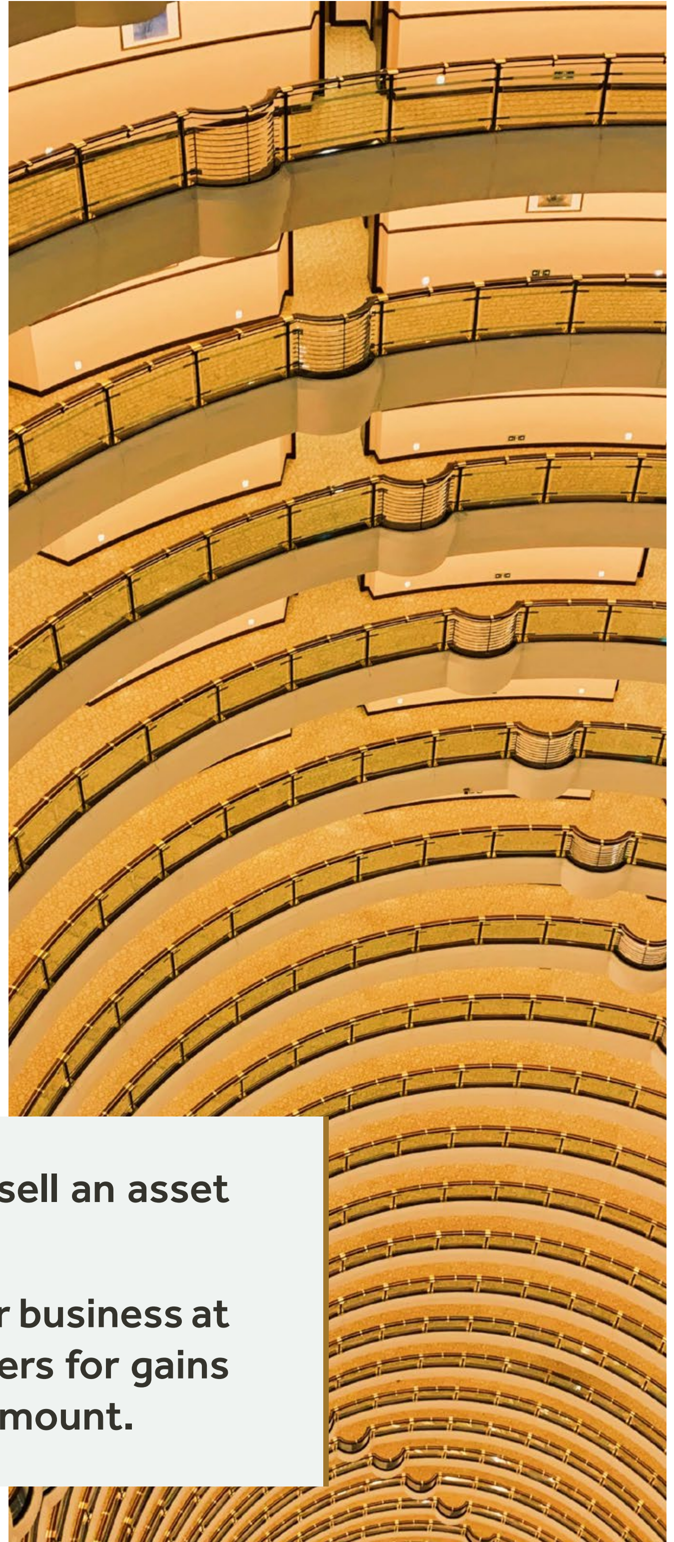
Entrepreneurs' relief means you will be charged CGT at 10% on the first £1million worth of gains, or profit, on the sale. For higher and additional rate taxpayers, who would typically pay the usual 20%, that's a significant saving of up to £100,000.

Again, the benefit is restricted like most other reliefs and allowances and it's up to £1million per person, so you can structure your shareholding with your spouse pre-sale to minimise the level of CGT due.

Any gains above the £1m threshold are taxed at the full rate - 20% if you've received taxable income or capital gains above £50,000 in 2020/21 for most parts of the UK, and £43,430 in Scotland.

There are a few conditions with entrepreneurs' relief:

- You must have held the business asset for a minimum of two years
- It must not consist of a property portfolio, held within a company structure
- You must hold at least 5% of the share capital of the business and be entitled to equal voting rights and profit distribution



CAPITAL GAINS TAX

CGT is a tax on the profit when you sell an asset that's increased in value.

It is potentially due on the sale of your business at a rate of 20% for Higher Rate taxpayers for gains above your £12,300 Annual Exempt Amount.

KNOWING YOUR NUMBER

How much you want to sell your business for and how much you need to sell it for are quite different. Whether you've used a price to earnings ratio, cost of entry to market, or stuck your finger high in the air - holding out for a full asking price offer can be counterproductive.

There are some big questions to ask:

- Why are you selling in the first place?
- What are your future goals and ambitions?
- What would you like to achieve post-sale?
- Would you like to leave a financial legacy for your family?

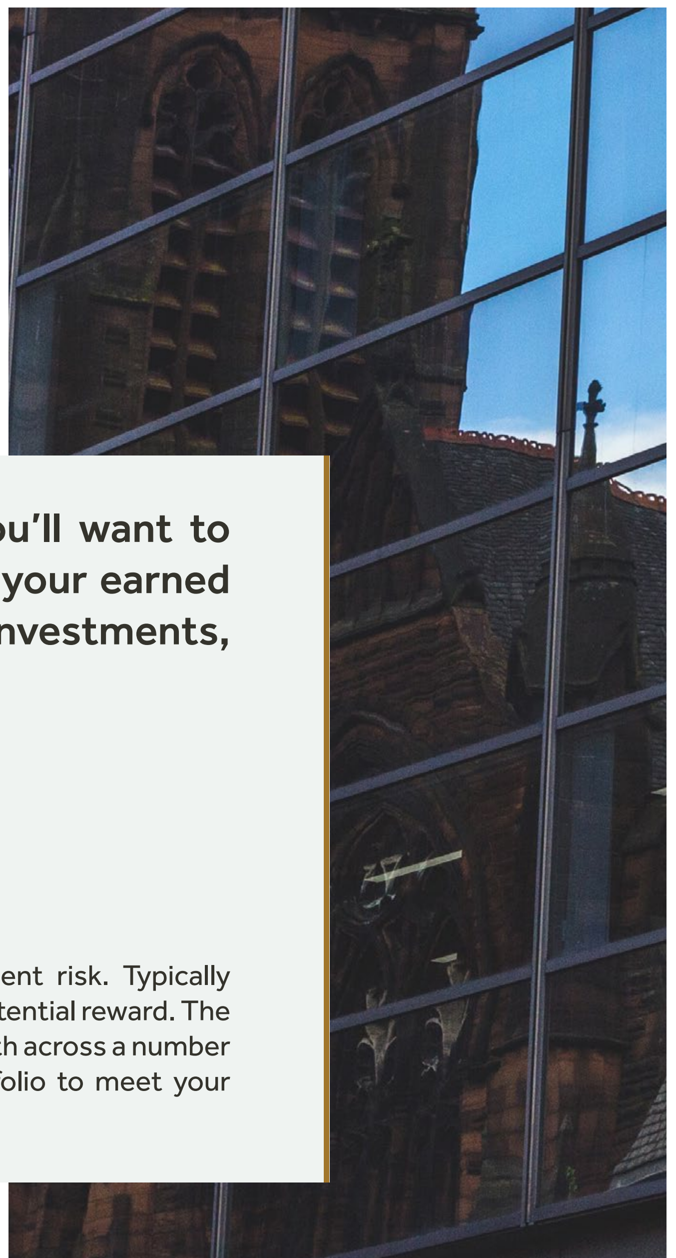
Knowing your number - how much you would need to live comfortably for the rest of your life - is key. If your business is valued at £6 million and your number is £4 million, would you decline a £5 million offer?

You can define your number with cashflow planning, which graphically represents your wealth over time, influenced by your decisions and external factors. It can consider shock events as well as planned, like the ultimate sale of your business.

By using cashflow planning and building a robust financial plan it becomes clear how much money you'll need for the rest of your life, how much you can afford to gift to family now, and the path to get there. You can make the right choices for you, your business and your family now.

YOU'VE SOLD

Now it's time for peace of mind. It's time to minimise 'YIKES' moments - whether it's a shock tax bill or unplanned expense. It's really important to be realistic with your lifestyle needs and expenses and have a robust financial plan to achieve these. Inevitably, having a big cash balance can influence your spending habits and deviate from the plan - agree and stick to the plan!



NEW TO INVESTING?

If you've just sold your business you'll want to invest some of your cash to replace your earned income. There are four main areas of investments, known as asset classes:

1. Shares or equities
2. Bonds or fixed interest securities
3. Cash or money market
4. Property or other tangible assets

Each asset class carries a different level of investment risk. Typically speaking, the higher the risk involved, the higher the potential reward. The idea is to spread the level of risk you are comfortable with across a number of different asset classes, creating a diversified portfolio to meet your growth or income needs.

STRUCTURING YOUR PORTFOLIO

The first thing to consider is the level of investment risk you are comfortable with. You can then build a diversified portfolio across several investments, with varying risk, all aligned to match your overall risk profile.

If, for example, you would like to be an angel investor and fund start-ups, this relatively high risk can be offset with other lower-risk investments within your portfolio. Once your portfolio has been agreed and to maximise the tax efficiency of the investment growth and your income, the tax shelters in which it is held should be considered.

There are a number of commonplace and more niche tax shelters, but first, let's cover the basics.

- **ISA Allowances**

Every investor's first port of call should be to use their ISA Allowance. Everyone in the UK over 18 years of age has a £20,000 annual ISA allowance in 2020/21. You can use all of your allowance for a Stocks & Shares or cash ISAs.

It's best to make use of your and your partners ISA allowances at the beginning of the tax year, giving your £40,000 investment the longest opportunity to produce tax-free returns.

- **Investment bonds**

An investment bond tax wrapper can be really attractive for higher and additional rate income tax payers, as all gains and income earned are taxed at just 20% within the bond, leaving no personal tax reporting.

Withdrawals up to 5% a year are allowed for 20 years without incurring a tax charge. So, if you invest £1,000,000 you could withdraw £50,000 p.a. from an investment bond, without an immediate tax charge.

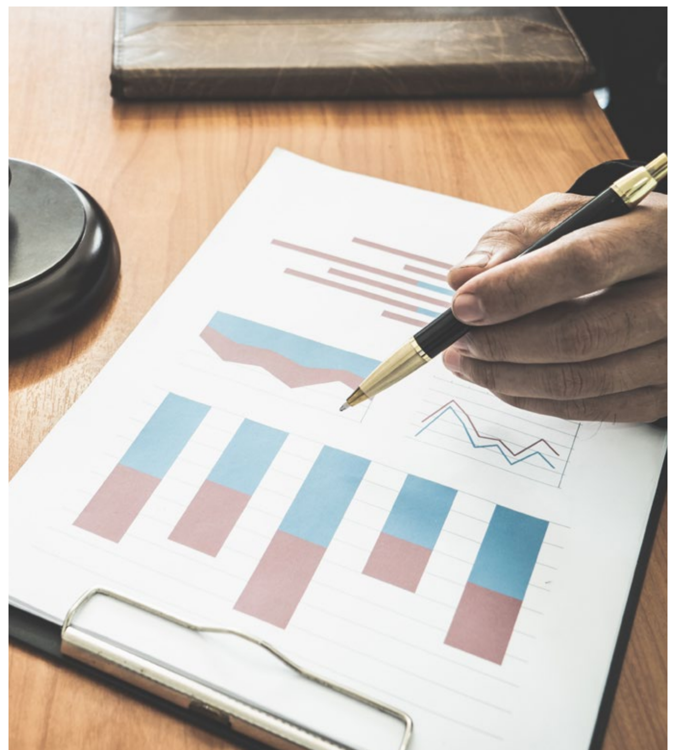
If you and your partner have a bond each, that's £100,000 a year - a great way to structure your income and, assuming modest investment returns, do so without chipping away at the capital value. Plus, if you don't use all of your 5% allowance in any given year, it will carry over to the next tax year.

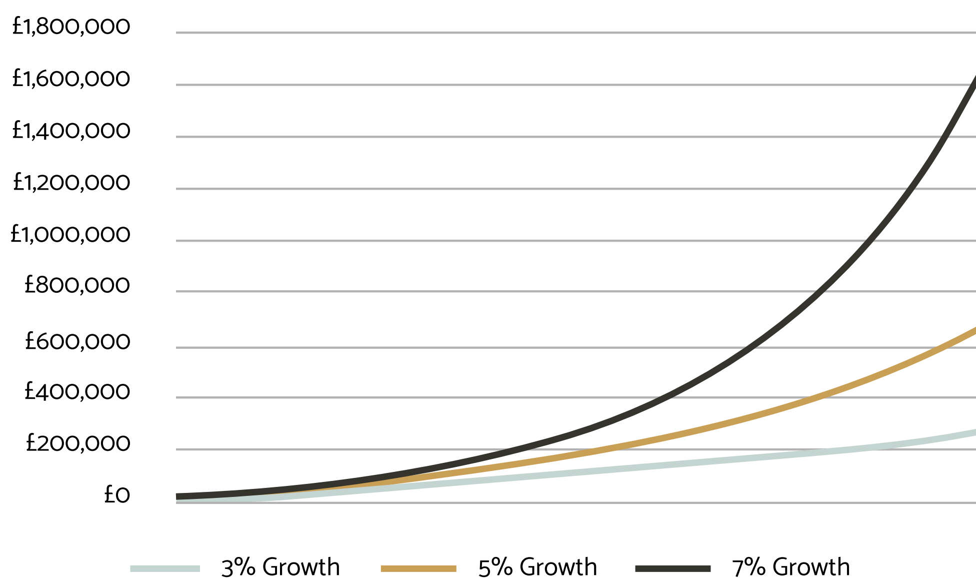
It's important to note that your tax bill does not disappear entirely. Instead, tax is deferred and any additional tax due will be payable at the time you cash in the bond, but remember basic rate tax is deemed to have been paid by the bond.

- **Investing for your family - Junior ISAs**

Junior Individual Savings Accounts (ISAs), like ISAs available to you, are long-term, tax-free savings accounts for your children. In 2020/21 the savings limit for Junior ISAs is £9,000.

There are two types of Junior ISA; cash and stocks and shares, and your child can have both. To be eligible your child must be under 18 and living in the UK. The savings are ultimately owned by your child, and whilst they can take control of the account when they're 16, they can not make any withdrawals until their 18th birthday.





Figures rounded to the nearest thousand, taken in the first month of the 55th year. Growth rates are net of charges and compounded monthly. This does not take into account the effect of inflation.

- **"Junior" pensions**

Another tax-efficient way to save for your children or grandchildren is to pay into a pension on their behalf.

In the 2020/21 tax year, you can pay £2,880 net into a junior pension. After tax relief, this adds up to £3,600. If at the beginning of each tax year you are investing the current annual maximum contribution until their 18th birthday, by the time they're 55 they could have a pension nearing or exceeding a million pounds!

With a total contribution from you of just £51,840 over 18 years, compound growth has a profound effect. By their 55th year, the following growth rates would provide:

- Low - 3% - £256,000
- Medium - 5% - £649,000
- High - 7% - £1,656,000

PASSING ON YOUR WEALTH

Before we get into the depths of Inheritance Tax planning and ways you can reduce sending huge sums to the taxman, let's consider the long-term financial wellbeing of those that will be inheriting your wealth.

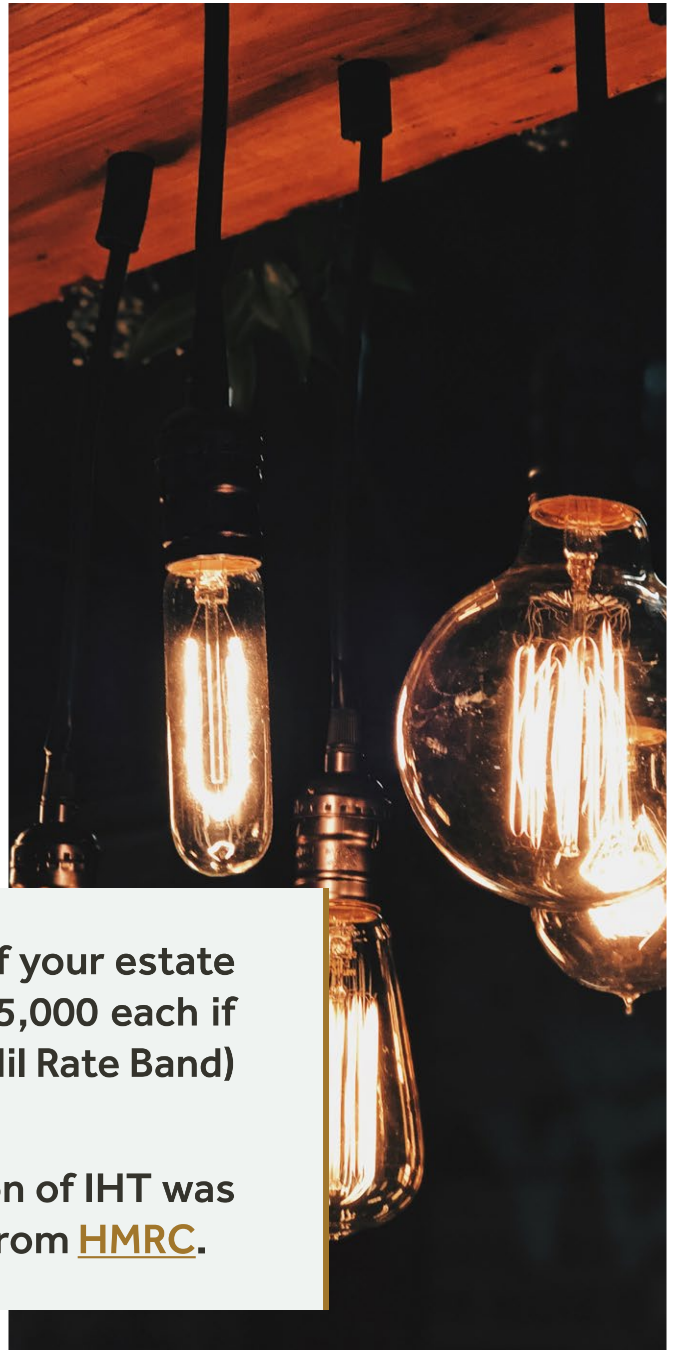
Whilst figures from the ONS suggest the average inheritance in the UK is only around £11,000, your children are likely to receive significantly more. It's vital to prepare them for this day and the psychological challenges of wealth. Get them involved in your financial planning process as soon as possible and financially educate them.

Most businesses and their assets are exempt from Inheritance Tax (IHT) thanks to Business Relief (also called Business Property Relief).

But, now you've sold your business you've quite likely created a significant IHT liability.

The amount of IHT paid has steadily been increasing year-on-year for the last decade. But, the use of business relief and value of exemptions dropped by 45% between 2014/15 and 2016/17.

INHERITANCE TAX



IHT is charged at 40% on the value of your estate above your Nil-Rate Bands (only £325,000 each if you don't qualify for the Residential Nil Rate Band) when you die.

A largely avoidable tax, but £5.4 billion of IHT was paid in 2018/19 according to figures from HMRC.

WHAT IS BUSINESS RELIEF?

Introduced more than 40 years ago, Business Relief is an IHT relief of up to 100%, intended to allow family companies to be passed down to generations. It also encourages investment in unquoted businesses.

Not all businesses or interests in a business qualify for relief. Dealing in land or commodities, financial activities and property development are all excluded activities. Broadly speaking, investments in the following attract 100% relief:

- Shares or an interest in qualifying businesses, not listed on any stock exchange, other than,
- Shares in qualifying companies listed on the Alternative Investment Market (AIM)

Shares in a qualifying business require to have been owned for at least two years to attract Business Relief. However, after you've sold your business, if you re-invest the proceeds in a qualifying asset or investment within three years of making the sale, the new investment will immediately attract Business Relief - which might be especially valuable in your circumstances.

There is usually a higher level of investment risk involved with AIM (alternative investment market) shares and other qualifying investments. There is no guarantee that tax legislation won't change in the future, but they are a particularly attractive IHT planning tool, especially after the sale of your business. It is also worth noting that some qualifying investments may be more illiquid (difficult to sell) than traditional stocks and shares, so they should be treated as a long-term investment.

UPDATE YOUR WILL!

One of the simplest and most important ways to reduce IHT is to make sure you have a valid up-to-date will. Surprisingly, almost 60% of adults in the UK don't have one. But, even if you do, after the sale of your business and a significant change in the way your wealth is structured, it's highly recommended you review and update your will accordingly.

GIFTING AND CHARITY

The vast majority of gifts, either cash or assets, are exempt from IHT if you live for seven years after giving them. However, this is not the cases if you still benefit in some way from the gift, known as a 'gift with a reservation of benefit'. People often unwittingly fall into this trap, especially when gifting property. If you continue to live in the property without paying market-rate rent, it would still be considered part of your estate for IHT purposes. Your children might also need to pay CGT when they come to sell it!

If you're gifting large regular sums to your children or grandchildren, as long as it conforms with 'normal expenditure out of income' legislation, your gift is immediately exempt from IHT. The exemption is only available for gifts made out of surplus net income, so it's worth getting financial advice to ensure you don't unintentionally create an IHT liability.

SHARING YOUR WEALTH, REDUCING IHT AND RETAINING CONTROL

Depending on your circumstances, one of the best ways may be to use a Family Investment Company (FIC). This is a company where the shareholders are various generations of your family.

Once set up, you can transfer or lend assets to the company, which could be property or investments. Usually, you would sell assets to the company for their market value, with the value remaining due to the original owner (often as a tax-efficient director's loan).

You can hold income shares so you receive dividend income, and/or capital shares. Over time you can give away company shares tax efficiently to your children and grandchildren as you see fit. The gifts of shares to family will be Potentially Exempt Transfers, which are immediately exempt from IHT.

The gifted shares will be disposals for CGT purposes, so it might be appropriate to gift shares shortly after the company is set up. You may also want to consider using trusts to potentially qualify for Hold-Over relief, meaning CGT would not be paid.

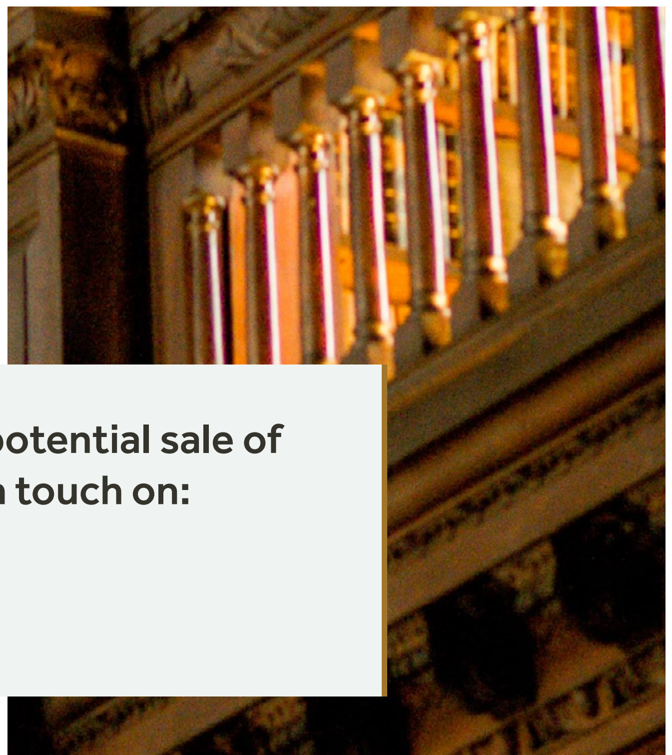
Your FIC can also invest in property, equities and bonds, just like you, so your wealth can continue to grow. Furthermore, your FIC's profits will be subject to Corporation Tax, not CGT, which is lower at 19%.

You may want to receive dividends from time to time, the distribution of which can be controlled by having different classes of shares. Control of the company can be achieved through the share structure and 'articles of association, allowing you to retain control if required.

Family Investment Companies can take many forms and be complex in their arrangement. It's important to take advice if this investment option is attractive to you.

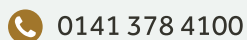
GETTING THE RIGHT ADVICE

Long-term, high-quality financial planning well in advance of selling your business is vital to appropriately plan for known and also unexpected events. With the help of a financial planner, you can minimise those 'YIKES' moments, save on a number of different taxes, and maximise your wealth for your family and future generations.



CONTACT

If you'd like to have a chat about the potential sale of your business, don't hesitate to get in touch on:



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