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## Buying or selling a business? What is involved?

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This article deals with the legal aspects of buying or selling a business. There will be many practical aspects that also need attention. For sellers, please also see our article: Preparing your business for sale.

Fundamentally there are two types of business sale:

- a transfer of shares
- a transfer of a business

### What is the difference?

A **transfer of shares**, or a corporate transfer, is only an option to the parties if the business for sale is run as a limited company, for it is the shares in the company that are transferred. The company is a legal entity in its own right enabling it to form contracts, take out loans, enter into leases for premises etc. Therefore it is the company that owns all the assets of the business and the sellers own the company by holding shares in it. Technically it is the company that is for sale, which happens to own all of the assets (and is burdened by its liabilities). When the buyer purchases the shares they take ownership of the company, in its entirety, exactly as it stands at that moment, with all of its assets and all of its liabilities, including tax liabilities.

A **transfer of business** can result in the buyer taking ownership of the whole or any part of the business allowing certain assets and/or liabilities not to be included.

For clarity, it is probably best to look at the main issues involved with each type of sale.

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## What are the main issues in a transfer of shares?

- Continuity

The company is a separate legal entity and it continues regardless of who 'owns' it. Therefore its day to day business should remain unaffected, its contracts with suppliers, customers and employees remaining in place.

- Simplicity

Because it is the company and not its owners that, for example, contracts for leases of property with landlords or enters into supply agreements with customers, there is no need to seek third party approval from landlords or customers for the transfer of individual agreements to the buyer. This can represent a large saving in terms of time and cost.

- Payment

The payment for shares goes direct to the shareholders.

If a company wishes to make a business transfer, i.e. a sale of all or some of the assets of the business, then the payment goes to the company: after all, it is the company selling the assets. The company will then have to make some form of distribution to pass the proceeds on to the shareholders (who have initiated the sale).

There is also a tax implication. The proceeds of a transfer of shares are dealt with by the individual and therefore there are several tax reliefs available. The proceeds from an asset sale will be dealt with under corporate tax regulations.

- Employees

Contracts with employees will not be affected by the sale because their contracts are with the company, not the shareholders selling the company. Much the same result is achieved in a business transfer by operation of the Transfer of Undertakings Regulations but the practical operations required to achieve those results can be quite burdensome.

- Stamp duty

A duty of 0.5% applies to a transfer of shares. The transfer of a major property asset could attract a rate of up to 4%. If the majority of the assets of the business for sale are property based this might affect a decision as to which form of sale to adopt.

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## **What are the main issues in a transfer of a business?**

- Selectivity

With the exception of the employees, whose rights to transfer with the business are governed by the Transfer of Undertakings Regulations, the seller and the buyer are free to decide which assets and liabilities will be included in or excluded from the sale. This will ultimately depend upon the relative bargaining power of the parties.

- Clean break

The purchaser does not inherit the past tax and trading liabilities of the business.

## **So which form of transfer is best?**

As mentioned previously, if the business is run by a sole trader or as a partnership there is no option of a transfer of shares: there are no shares to transfer. So you only need to worry about the decision if the business is run as a limited company.

As for which form of transfer is best - this is entirely dependent upon the circumstances of the business, the seller and the buyer. Of course, what is best for the seller may not be best for the buyer and this may form part of the negotiation.

You will need to take expert advice from an accountant, a solicitor and possibly a specialist corporate finance adviser to help you work through the relevant issues.

## **Once the form of transfer is decided what is involved?**

The processes involved in a transfer of shares and a transfer of business are very similar. In fact both of them will contain all or some of the following common elements:

- An exclusivity agreement (Lock-out)

This document will prevent the seller from negotiating with any other interested buyer during an agreed time period. This will allow the buyer time to seek expert advice and to carry out due diligence (see below).

- A confidentiality agreement

In order to reach a purchase decision the buyer will want to see certain confidential information that the seller will consider to be trade secrets. In some circumstances the information may be the primary asset of the business and it is understandable that the seller will be reluctant to release it prior to reaching a binding agreement on the sale. The confidentiality agreement

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binds the buyer into not using the information (other than to assist the purchase decision) or disclosing it to anyone else.

- Due diligence

The buyer will want to ensure that the business is worth the price being asked for it. Many questions will need to be answered by the seller to the satisfaction of the buyer. This should include examination of:

- the seller's title to any property included in the sale.
- the seller's title to any intellectual property included in the sale.
- the continued enforceability of any key contracts the business has with third parties.
- insurance policies.
- compliance with statutory regulations.
- employment contracts and how the Transfer of Undertakings Regulations may affect the sale.
- reports from other professionals such as accountants and surveyors.
- records filed with Companies House (if appropriate)
- things specific to the business and the buyers intended use of it.

- Service agreement

If one or more of the sellers is to continue to be employed by the business a suitable contract will need to be agreed upon.

- Sale agreement

This is the main document setting out the details of the agreement between the seller and the buyer. It is likely to be a larger document in a business transfer because it will need to contain greater detail to clarify exactly which assets and liabilities are included in the sale and deal with any employee issues.

Indeed the size of the agreement can vary enormously depending on whether it is drafted by the seller or the buyer and their relative negotiating strength. This is because a buyer will want to include warranties that may run to many pages, whilst a seller would prefer to keep warranties to a minimum (none if possible).

- A disclosure letter

If the sale agreement contains warranties by the seller, the seller may want to make specific exception to those warranties. The seller can disclose those exceptions in the form of a disclosure letter, which will prevent them from being subject to a warranty claim.

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- Directors and shareholders' meetings

If either the seller or the buyer of the business is a limited company, certain formal meetings will need to take place and be recorded to approve various aspects of the transaction.

In addition to the above a transfer of shares will usually require:

- a deed of tax indemnity

This document sets out that tax liabilities relating to a period prior to the date of the transfer will remain the liability of the seller.

If you would like further information or advice please contact Steven, Tom or Philip who will be happy to assist you or visit [www.gardandco.com](http://www.gardandco.com).

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