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Purchasing a Business

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Your guide to Purchasing a Business

This guide is intended to provide you with a brief outline of a typical business acquisition. All transactions are, however, different and there may be greater or less requirements on a case by case basis.

There are many reasons why purchasing an existing business may be preferable to starting a business from scratch. You will be taking on what is hopefully a profitable business with a good reputation with much of the ground work already done in setting up the business, the market for the product or service having been demonstrated and established customers providing a reliable income. Existing employees will have experience that you can draw on and the firm will have a useful network of contacts and as a result it should be easier to obtain finance for the business.

Purchasing and running a business is complex and involves many areas of the law and this guide can only provide brief insight into some of the areas that you need to consider.

How to value a business?

Running a business is never easy it is essential that you should speak to an accountant prior to agreeing a price and seek their advice. In some cases you will need to obtain advice from a specialist valuer. Before agreeing a figure you need to form a general idea of the strength of the business by enquiring into its history, its current performance in the form of sales, turnover and importantly profit, its financial position with regard to the cash flow, the extent and type of its assets and any debts, expenses and ongoing liabilities and commitments.

You should also consider why the business is being sold and research its future prospects (e.g. is a major competitor coming to the area?). You should speak to the vendor and if possible existing suppliers and customers to obtain answers to some of those questions. You should consider whether there are any unusual or non-recurring profits which will not be repeated in future years.

It is particularly difficult to value "intangible assets" which would include the company's reputation and relationship i.e. the value of the firm's goodwill. No matter how confident you are of your own ability always be wary. The individual reputation and connections of the seller can be very important (for example a restaurant where the owner is also the chef).

Due diligence

Once you have agreed on a price we will receive the contract from the seller's solicitor, will seek to check that the information that you have been given is correct and will make other relevant enquiries (i.e. will carry out due diligence enquiries). It is essential that you give us full details of all the information you have been given and on which your decision to buy was based. The results of our enquiries should give you a realistic idea of how the business is performing now.

The key areas that we will consider as part of the due diligence are :-

1. Employment terms and conditions

There are regulations which govern what happens to the existing employees of the business when someone else acquires that business. These regulations apply to all employees when a business is transferred as a going concern and the general effect is that the employees are deemed to carry on working for the business under the same terms and conditions as they did for the previous owner. These regulations are called the Transfer of Undertakings (Protection of Employment) Regulations (TUPE). TUPE applies equally to transfers of both large and small businesses and in the event of a dispute an employment tribunal or, on appeal, a higher court would decide whether TUPE applies. TUPE may not apply where:-

- There is a transfer by share take over – when a company's shares are sold to new shareholders there is no transfer of the business itself since the same company continues to be the employer and there is therefore no need for the regulations to apply.

- When a business transfers assets only e.g. equipment is sold.
- When a business transfers a contract to provide goods or services that do not involve the transfer of a business.
- Transfer of businesses which are situated outside of the UK, although similar provisions may well apply in the EU.
- Changes to the organisational structure of a business.

In most cases TUPE will apply and therefore you must bear in mind that by taking over the business you are taking over the contracts of employment for the employees and you are now subject to all the employees' rights including their existing redundancy entitlements i.e. from the time their employment in the business commenced. As a result you are not able to change the employees terms and conditions to their detriment. Any change that you did make could be constructive dismissal entitling the employee to claim compensation for unfair dismissal. We will make enquiries to ascertain full details of the existing terms and conditions of employment of each employee and advise you of their existing rights and entitlements. You are not able simply to agree with the seller that he will dismiss employees before the business is transferred to you as you could still face a claim for unfair dismissal in those circumstances. We may suggest obtaining specific TUPE related advice if the matter is complex.

Before acquiring the business the seller is required to inform and (where you intend making changes that will affect employees) consult with officials of any recognised trade union or any other employee representative (or in the absence of any with the affected employees direct) and you must provide information to the seller of any action that you intend to carry out that will affect their employees well before the transfer to give adequate time for consultation. If a consultation is not handled sensitively it could result in low morale of the work force and a feeling of insecurity and therefore it would be in your interests to emphasise the positive benefits of your purchase of the business and to demonstrate how as a result the prospects for the business and therefore for the staff will be improved.

If, because of the transfer or a reason connected with it, you dismiss employees who have one years employment or more, they will in most cases automatically be held to have been unfairly dismissed and will be able to claim compensation from you.

However, if there is an economic, technical or organisational reason entitling changes to the workforce then you may be able to dismiss fairly provided you follow a fair procedure. This is a complex area of the law and we request that you advise us immediately if you have any intention of changing the employees terms or dismissing any so that we can advise you fully prior to completion of the purchase.

2. Outstanding litigation

We will seek to ensure that there are no claims being pursued against the business.

3. Major contracts and orders

We will make enquiries to ascertain what contracts are in existence (both as to the supply and receipt of goods and services) the terms of such contracts and whether they can be transferred to you. You may need to honour or renegotiate an existing contract which the previous owner of the business may have made. It may not be possible to ensure that previous customers must continue to deal with you.

Purchase price

The Purchase price of a business is likely to be apportioned between the premises (which might be leasehold) the goodwill of the business and the fixtures and fittings. You should ask your accountant to advise you as to the most tax efficient way for the price to be divided between those options since this will have income tax and capital gains tax implications for you.

In addition to the agreed price you will be required to buy the stock of the business at cost price.

Business premises

If the premises are freehold we will check the title and will arrange for its transfer to you.

Many businesses however operate from leasehold premises and it is most important that you understand all the implications of the terms of the Lease. If the premises are leasehold please ask us for our client guide to commercial Leases. Our guide explains the need for you to ensure that you are only paying the market rent and that you are aware of the terms of the Lease including the length of the Lease and the rent and rent review provisions and whether there is any ability for the Lease to be brought to an end early. It is also fundamental that you are aware of the repairing obligations in the Lease since most Leases are on a full repairing and insuring basis (known as FRI) which means that the Tenant is responsible for all repairs and the cost of insurance of the premises.

Whether freehold or leasehold we strongly recommend that you obtain a survey of the premises. If you will be purchasing an existing Lease then it will be necessary for you to obtain references normally from a bank, accountant and a trade or previous landlord's reference confirming that you will be able to meet the rent. Those references will be needed by the Landlord to enable him to consider agreeing to the sale of the Lease to you.

Planning and other permissions

We will check that the premises can be used for the intended use since even if a Landlord grants you a Lease for that use you would have no claim against him if you later discovered that planning permission was required but would not be granted.

We will also establish what other licences or permissions are in force enabling the operation of the business e.g. a drinks licence and where appropriate arrange its transfer to you.

VAT

Whether VAT is chargeable on the whole or part of the purchase price depends on the circumstances in each case. It is often possible to avoid VAT being charged in addition to the purchase price of the business by registering for VAT before the applicable tax point. Your accountant will usually be able to deal with the VAT registration for you.

Furthermore be aware that many Leases entitle the Landlord to charge VAT on the rent and if the Landlord were to do so and you were not VAT registered then you would not be able to recover what would effectively be an additional rent. You should ask your accountant to arrange the VAT registration prior to exchange of contracts.

Structuring the business

We will be able to provide advice in conjunction with your accountant on how the business should be structured whether as a sole trader, partnership, limited liability partnership or limited company. The choice of structure or any change in a structure needs careful consideration and will depend on much more than simply whether it can result in a tax saving. The decision may affect how the business develops including the ease with which the business can attract outside investment and it may also determine how easily you will be able to sell the business in the future. You should seek advice at an early stage of the purchase.

Health and safety at work

Once you have purchased the business and become an employer you will be responsible for providing a safe place of work. Good practice requires you to have a written statement of your safety policy which is available to all of the staff. You are also required to provide adequate staff training and to record all staff injuries and indeed to report serious injuries to the health and safety executive. You will also be required to display a current employers liability insurance certificate.

By signing the firms terms of business that accompany this guide we consider you to have been advised of the desirability of reading this guide in full.

We hope that this short guide has helped you in understanding more about what it means when purchasing a business. We would be pleased to meet with you to discuss any questions that you may have.

Please call us on 01305 768888

We will then put you in touch with a member of our experienced Business team.

Please visit www.pengillys.co.uk where full details of our Business team are available.

For further details about Pengillys and how we work, please refer to our Terms of Business and Privacy Policy which are available on our website or on request as printed documents.

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