# The Entrepreneur Lifecycle – Part III: Realising Value and Exit

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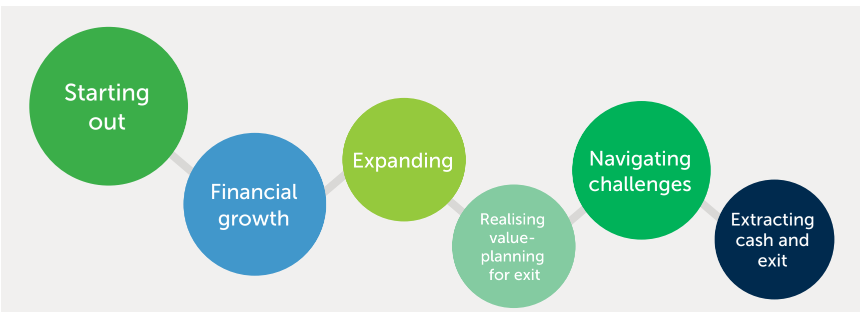
**This article is the third in a series of three articles that examine the entrepreneur lifecycle and the key considerations that entrepreneurs should think through at each stage in the cycle. In this article, we will focus on the realising value and exit phases of the lifecycle and consider issues such as how the business owner can access some value, how the business might be transitioned and facilitating an efficient exit for the business owner.**




Planning for exit at an early stage can mean a more efficient sale when the time comes. Leaving all thoughts of exit planning and how to access value too late can result in inefficiencies and tax leakage. In many cases business owners may not have a suitable corporate structure in place in order to facilitate an exit from the business. Once the time comes to exit there may be value in the company that is not associated with the trade and which needs to be segregated.

In other cases the manner of the exit may not be a straight sale of the company or business to a buyer, but instead it might be more nuanced, such as a management buyout of the business, sales with deferred consideration, earn outs etc. As such, engaging in planning and having a suitable corporate structure in place at an early stage, which can be adapted to varying scenarios, can make the transition of the business to the new owners more efficient.

## Pension Planning

While early planning and structuring are key considerations in planning for exit, a simple first step that might be taken in the years preceding an exit might be to examine the level of pension contributions for the business owner and determine whether there may be scope to increase such contributions.

While pensions funding should ideally be put in place as early as possible in someone's career, it is often the case that business owners neglect their pension planning, perhaps due to cash flow needs in the business, to fund expansion etc. As such there might be scope for significant pension contributions in the years immediately preceding an exit. This is one of the most efficient and simplest ways for business owners to access value and fund their retirement.

## Early Planning

In many cases where a business has been developed from a start-up it can often be the case that excess cash in the company has been used to invest in other assets. Such assets may come to represent a disproportionate amount of value within the trading company.

When it comes time to start planning for exit, these assets cause a complication because any potential purchaser may not wish to acquire such investment assets (as the cost of funding this could be considerable). In addition the business owner might wish to retain these investment assets for their own benefit or for the benefit of their family.

Thus, segregating those investment assets from the trade assets may need to be considered. From a risk perspective separating your investment assets from trade assets provides an element of security as those assets are no longer subject to the trade risks in the trading company.

The more advanced the business has become and/or the more investment/non-trade assets held within the company the greater the difficulty of segregating them becomes. In such scenarios high valuations of assets can result in tax leakages and in addition the more complex the assets structure of the business the more commercially and legally difficult the process of segregation may become.

Thus, separating out trade and non-trade assets as early as possible can make a later exit more straightforward. If following segregation funding is required for the business, a golden share could be put in place to allow intercompany lending, while still protecting the bulk of the investment asset value in the investment company from trade risks.

## Use of a Holding Company – Pros and Cons

Another issue that many business owners have to deal with is whether to put a holding structure in place for their trading business or whether to hold shares directly. Holding companies are often promoted as offering considerable benefits, largely due to the fact that there is potential for a trading company to be sold by its parent company without incurring any CGT due to the application of the CGT participation exemption. While this is true, the question that must be asked is, does the business owner require any funds personally on the sale of the business or would they prefer to leave all the proceeds in a holding company structure?

In many cases, the value of a business owner's trading business forms the bulk of their personal wealth and thus on a sale of the business they would want/need some funds personally. By interposing a holding company you may be locking away capital from the business owner and their only mechanism to access funds is to take a dividend (and pay marginal rate income tax) or wind up the holding company and pay CGT at 33% (defeating the purpose and benefit of a holding company). Thus, reaching the right balance of accessing enough funds personally to meet living/retirement costs and retaining funds in the holding company for future investment opportunities is important.

One solution might be for the business owner to transfer some of his shares to a holding company and retain the balance of shares personally. In this way the business owner gets cash in their hands on sale (possibly availing of CGT retirement relief or entrepreneur relief), with the balance of funds held in a holding company that can be used as an investment vehicle for the business owner or their family in the longer term.

In implementing such a split in shares between the business owner and the holding company, care needs to be taken to manage the potential CGT and stamp duty costs of putting the structure in place. For CGT purposes, relief on a share for share transaction can apply where the holding company acquires control of the trading company but in the case of stamp duty the holding company must acquire at least 90% of the shares. Depending on the value of the business it may not be desirable for the holding company to have such a large shareholding and thus stamp duty share for share relief may not apply. Thus, by engaging in planning early, perhaps while valuations are low, an optimum structure can be achieved with minimal tax leakage.

## Other exit considerations

The nature of the exit from the business can vary greatly from case to case. The most straightforward being an outright sale of the business to a buyer. In other cases, the exit might be to a management team by way of a Management Buyout ("MBO"). The management team might put an MBO company in place to purchase the business/trading company.

To do this they will likely need bank funding, but perhaps there may also be a need for a level of vendor funding as well (e.g. a loan note representing a deferral of the consideration owed to the vendor for the business). As such, the vendor may need to leave some value on the table for the time being to give the management team an opportunity to raise enough funds to buy them out fully. In such a case the vendor needs to ensure they obtain enough

funding to cover any tax costs arising for them on the disposal plus perhaps funding for their living expenses, (the CGT liability will generally be triggered on the disposal regardless of whether funds are received).

In other cases the sale might involve an earn out. In such cases, particularly where there is a holding company in place, it is important to ensure the earn out is correctly valued so that CGT participation exemption can be availed of. If an earn out is undervalued and CGT arises on any excess funds received, then there may be a risk to the application of CGT participation exemption on that element of the proceeds.

As can be seen, depending on the nature of the exit from the business a whole host of considerations need to be taken into account to achieve an efficient outcome.

## Tax Relief on Exit

Depending on how the business assets are held, there are a number of reliefs which business owners may wish to avail of. Generally the reliefs most people may seek to rely on are CGT retirement relief and CGT entrepreneur relief. For retirement relief an individual over 55 years can sell their business for up to €750,000 and get full relief from CGT. Once they go over 66 years of age, the threshold is reduced to €500,000.

CGT entrepreneur relief applies to individuals of any age but there are a number of conditions to be met in order to avail of the relief, which can sometimes prove onerous. Where the relief applies, the rate of CGT on the first €1million of gains is reduced from 33% to 10%. Any excess gains over €1million are chargeable to tax at 33%.

Where the trading company is owned partly or wholly by a holding company then participation exemption may be sought to relieve the gain on the sale by the holding company from tax, and thus have the gross proceeds available for reinvestment.

In some cases, the value of the business might be such that there is little or no benefit from relevant reliefs. By way of illustration, a business owner over 55 years of age might sell their business. If the business is worth say €2million (with no base cost as it was a start-up business) then CGT retirement relief will be of no benefit. The current threshold of €750,000 is exceeded and marginal relief (i.e. limiting the amount of the taxable liability to 50% of the value over €750,000) is of no benefit.

CGT entrepreneur relief may be available if all relevant conditions are met but a tax liability of €430,000 could still arise for the business owner (i.e. €1million at 10% plus the remaining €1million @ 33%). Although the relief is welcome, the threshold is quite low, and the conditions can be quite restrictive in certain cases. While it might be said by some that a tax liability of €430,000 on the sale of a €2million business is not a bad outcome (an effective tax rate of 21.5%), it should be borne in mind that for many business owners this value represents years of personal investment and risk in the business and may well be their retirement fund (many business owners do not have significant pension funds in place typically due to reinvesting profits into the business as opposed to retirement planning). Thus, the erosion of €430,000 in value is significant.

In the above scenario, if the business owner had engaged in some early planning they might have been able to obtain enough funds directly from the sale to optimise either CGT retirement relief or entrepreneur relief, with the balance of funds held in a corporate vehicle available for investment. Should they need to top up their income in the future they might take periodic dividends from the company to meet their requirements but maintain the bulk of the funds in the corporate vehicle.

## Conclusion

Early engagement with planning is crucial. While it is not possible to foresee all eventualities, there is a degree of planning/structuring that can be undertaken at an early stage to make sure that when the time comes to exit, that process is made as efficient and seamless as possible. In the absence of any planning as to how a business owner might exit there is a real risk of significant tax leakage and perhaps commercial and legal costs in trying to package a business for sale at the last minute.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