

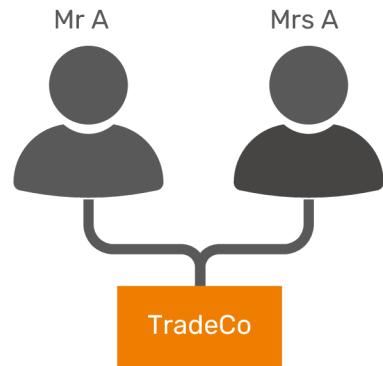
Management Buyouts

What is a Management Buyout?

A management buy-out ('MBO') is an exit strategy for shareholders, allowing the company to be sold to its management team.

An MBO takes place when the owner would like to retire and hand the business on to the next generation of management. It can also be used when a company wants to sell parts of its business to a management team.

A Typical Process



Key Consideration

- Is there a strong management team? There's no point selling to a management team that is not yet ready, unless the vendors are prepared to stay involved for a significant period of time.
- Is there a need to hire key managers from outside the business? An MBO can be enhanced by hiring one or two key senior people to supplement the existing management team (sometimes called a management buy-in, or partial buy-in).
- Does the owner have realistic price expectations? Since the transactions are often completely financed from the profits of the business, it is essential that the price set is reasonable.
- Is there a record of profitability from the company; will this company succeed? If the transaction is to be financed from future profits, we need to be as certain as possible that the company will thrive under the new management team.
- Should the management team put up an amount of 'Hurt Money'? The transaction does not require the management team to put up any initial cash, but many vendors feel that it is important for the managers to have some 'skin in the game', so that they have a reasonable sum at stake that is dependent on the success of the company.



A Typical Process

Background

Mr A and Mrs A each own 48.5% of TradeCo. They would both like to retire and wish to sell their shares to the two most senior managers in the business, Mr B and Ms C.

Both Mr B and Ms C have worked in the business for several years and are key members of the management team. They have offered £1m to purchase 100% of TradeCo and will own 60% and 40%, respectively.

Mr B already has 3% of the shares of TradeCo from previous share awards.

Step 1

The first step would be for Mr B and Ms C to incorporate a new company, BidCo. Typically, Mr B would subscribe for, say, one £1 subscriber share and Ms C for four.

If it is decided that Mr B and Ms C should make an investment, they should do so at this stage. They can put the cash in as part of the subscription for their shares ('equity investment') or they can lend the money to BidCo at this stage.

Similarly, if the MBO is being financed by external debt, this is the stage at which the lender will lend the money to BidCo.

Step 2

BidCo would then buy the entire share capital of TradeCo from Mr and Mrs A for £1 million.

Step 3

Mr B is selling his 3% of the shares of TradeCo to BidCo. In consideration, BidCo will issue him with five new shares, so he now holds six shares to Ms C's four (so 60:40, as agreed).

Usually, TradeCo will have some distributable reserves, which can now be paid as a dividend to BidCo, to allow BidCo to pay part of the £1 million due to Mr and Mrs A (or to an external lender). Similarly, any cash invested into BidCo by Mr B and Ms C can also be used to pay off part or all of the debt to Mr and Mrs A.

The rest of the consideration can simply be deferred, and paid as profits arise in TradeCo, or the debt can be recognised by a loan note or debenture, which is a more formal kind of debt. In effect, though, the remaining consideration will always be funded by the future profits of TradeCo being dividend up to BidCo.

Commercial Advantages

- Control and Continuity: The management team on an MBO is already familiar with the business, which ensures a smoother transition.
- Motivation and Incentives: Management should be more motivated to grow the business as they now have a direct financial stake in its success, especially if they have invested in the business, too.
- Employee Stability: A third-party business sale inevitably leaves existing staff feeling vulnerable, and often with good cause. An MBO is usually a stable transition where employees are familiar with the new owners and their management roles and can be comfortable that any change is likely to be gradual.

Commercial Disadvantages

- Complexity and Costs: The process involves complex structuring and significant legal and financial costs.
- Vendor Risk: If the business does not perform as expected, the vendor shareholders may not get all (or any) of the money they expect from the sale, as the payback is wholly dependent on TradeCo making sufficient profits to pay off its debt.
- Management Risk: The management team may be required to take on significant debt to finance their shares of the buy-out, or to give personal guarantees of any loans to BidCo, which can be risky if the business does not perform as expected.

Tax Positions

- Shareholders who dispose of their shares in a trading company, such as Mr and Mrs A, may pay capital gains tax (CGT) at a lower rate (currently 14%, rising to 18% on 6 April 2026) than the main rate of CGT (currently 24%), subject to satisfying the conditions to qualify for 'business asset disposal relief'.
- Shareholders borrowing money to invest in the business – Mr B and Ms C, for example – can claim income tax relief for the interest paid on their loans. (However, if BidCo pays them interest on their loans to the company, this interest will be taxable.)
- Mr B sold shares of TradeCo in return for new shares in BidCo: in this situation, we would expect any gains on his TradeCo shares to be simply 'rolled over' into the new shares issued by BidCo, so he does not suffer CGT on the sale of his TradeCo shares.
- While TradeCo will be subject to corporation tax on its profits, the dividends to BidCo are tax-free, so the tax leakage is eliminated, allowing BidCo to pay its debts as quickly as possible. Typically, pay-back on an MBO is three to five years, although there are no rules about this and longer or shorter periods are possible, usually based on the cash flow needs of the company.
- Professional costs incurred during the MBO may not be deductible for corporation tax purposes as they are considered capital expenses.
- While a transaction in shares, as this is, does not carry VAT, there will be VAT on the professional fees incurred on the transaction – lawyers, tax advisors, accountants, valuers, corporate finance advisors, lending fees ... Sadly, these fees are generally not recoverable.
- BidCo will be required to pay stamp duty in respect of the transfer of the shares of TradeCo from Mr and Mrs A. The rate is ½%, so in the £1 million transaction in our example, the stamp duty will be £5,000. (If the stamp duty is a significant cost, there are mitigation mechanisms, which appear to be acceptable to HMRC.)

Get in Touch



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As a member of the ICAEW and CIOT Nick specialises in technical corporate tax planning and company reorganisations advising on a variety of projects from mergers and acquisitions to company incorporation, management buyouts and demergers. Nick is a regular writer for various tax journals with articles published in Taxaction, Tax Advisor and ICAEW Taxline. Presenting regular lectures to fellow professionals through various CPD providers including MBL, CPDStore and a variety of CIOT branches.



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Pete began his career with the Inland Revenue in 1988 with roles in tax districts in Birmingham and London before spending several years in head office, culminating as the Inland Revenue's expert on the rules for company distributions and advance corporation tax. Since going into private practice 25 years ago, Pete has worked for Big 4 firms and run his own business for 11 years, advising a wide range of clients from owner managed businesses to the largest corporate groups. Pete is Chair of the CIOT's Owner Managed Business Tax Technical Committee, as well as being a member of the Tax Policy and Oversight Committee and of the Education Committee.

Client Testimonials



Our company Emerald Associates met with Nick who was courteous and helpful from the outset. It was also very reassuring to have our accountant, who was present at the Teams meeting, say that he had used their services and that they were indeed the experts in the field of Tax. Nick provided great clarity.



I've worked with Pete Miller and Nick Wright from Jerroms Miller on a few projects and each time have found their assistance and expertise invaluable. They and their team have a wealth of expertise and experience across a broad spectrum of taxes, in particular corporate reorganisations.



Jerroms Miller have provided specialist tax support on a number of transactions and reorganisations for our clients. As well as being technically very good Pete and Nick provide excellent ongoing support to clients both during and after the transactions which is both valuable and reassuring.



Jerroms Miller are a fantastic resource for dealing with our complex tax issues or when we need a second opinion on a technical query. Pete, Nick and the rest of the team are always quick to respond with clear and concise advice.



Nick Wright is joined by leading industry experts on the **@TheTaxHour** Podcast.
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