SOWERBY
CHARTERED ACCOUNTANTS

WINTER NEWSLETTER

CONTENTS

- COMMENT - IS YOUR BUSINESS WELL GROOMED?
- BUSINESS - ECONOMIC OUTLOOK, INFLATION AND YOUR BUSINESS
- ADVICE AND BEST PRACTICE - CAPITAL ALLOWANCES AND SUPER DEDUCTION
- SOWERBY

"As we close the book on 2021 and begin to look forward to 2022, we do so with cautious optimism. Following some great feedback from our first newsletter we hope to continue providing value throughout this year and beyond. The past 3 months have not been as straightforward as we had hoped but we remain here to support you amid the changing regulations, circumstances and economic trends that look set to continue. From all at Sowerby, we wish you a happy and prosperous New Year"

- Adrian Allen

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COMMENT

IS YOUR BUSINESS WELL GROOMED?

Most business owners will at some point want to realise their wealth and sell their business. To ensure you maximise your business's potential you need to ready your business for sale, just like you would your house.

To achieve this, there are several key areas that you should review:

MANAGEMENT TEAM

The management team are as important as the profitability of the business, as without them, the business cannot function effectively. It is never too early to start building a strong management team. If all the major parts of the business are run by you, the business owner, the business will struggle to cope with the loss of your management when you sell and potential buyers will utilise this issue to drive down the price. It is also important that the management team are aware of your sale objectives, in terms of both value and timescales.

SYSTEMS AND ADMINISTRATIVE HOUSEKEEPING

It is important that all your systems and procedures are well documented and up to date. All key information on staff, customers and suppliers should be summarised with any signed contracts to hand.

Lack of formal documentation can cause a significant delay in sale processes. The company should also ensure that the company's statutory books and records are up to date.

BUSINESS STRATEGY

It is important that the company has a well-developed and integrated business strategy so that all the key business stakeholders (shareholders, management team, and staff) are aware of the goals for the company. This should include a written business plan that is reviewed annually, usually done at an annual strategy meeting.

PROFIT MAXIMISATION

It is important to consistently review the business cost structure to ensure the company is efficient. This does not mean cutting costs just prior to the sales process. Rather, strategic reviews of costs should be undertaken to ensure that the technology and systems incorporated into the business are proficient and effective.

AVAILABILITY OF FINANCIAL INFORMATION

As part of your systems review it is important to ensure that your financial software can assist the management team in producing information that will be helpful to the sale process. This information should include profit margins by product / service, management accounts reconciled to your annual accounts to ensure the management information is accurate, detailed forecasts and cashflows for at least the next 12 months, with outline projections for a longer period as well. You should also reconcile actual results to the projections with commentary on any variances. Incorporating this requirement into your infrastructure now will give huge comfort to any buyer that the management team understand the business.

THE SALE PROCESS

It is important to understand the sale process so that you are aware of how the sale will proceed. It is also important for your advisers to understand your goals and aspirations, to ensure these are incorporated into the sale. Whilst most people assume the highest price is the sole goal, this is seldom the case, with sellers often as keen to ensure their employees are protected, and the buyer has similar ethos.

Understanding the tax implications of selling are also important, so it is imperative that you are comfortable with your advisers.

The points summarised above are not an exhaustive list, but just an example of the key points to consider. It is likely that the majority of this is already being done by most businesses, but not necessarily in a formal way, which is why there is a need to plan for the day you do want to sell your business.

The sooner you incorporate these points into your business the better, as it will become part of the business's culture and should therefore make the business more saleable.

At Sowerby, we can help you groom your business for sale, and even if you decide not to sell, and instead transfer the business to the next generation, these keys points will help grow your business.

If you would like to discuss a sale of your business, please contact your Relationship Partner or Richard Skewis.

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BUSINESS

ECONOMIC OUTLOOK, INFLATION AND YOUR BUSINESS

December saw the Bank of England unexpectedly raise interest rates for the first time in three years.
The surprise decision, which saw interest rates being raised from the historic low of 0.1% to 0.25%, came amid a collapse in consumer confidence due to the spread of Omicron. The execution of the change before the extent of economic damage driven by the new variant could begin to be fully assessed, underlined the deep concern over inflation rates being at their highest for a decade.

This is combined with warning from the Bank that there was unlikely to be any reprieve over the winter months as inflation is expected to increase from 5.1% at present to 6% next spring – three times its 2% official target. With this increase driven at least in part by soaring energy costs and global supply bottle necks, any dissipation will clearly take time.

RISING COSTS AND CONSUMER BEHAVIOUR

With such an inflationary increase it is no surprise that price rises are now a constant topic of conversation. Fuel, food, energy supplies, shipping, our clients tell us that there doesn't appear to be anything that has not seen a significant price increase in recent months.

It is all too easy to suggest that businesses merely apply an inflationary price rise to their products to account for the cost increases they are seeing.

However, at its most simplistic, inflation reduces the purchasing power of money since more money is now needed to buy the same items. High rates of inflation therefore mean that unless income increases at the same rate, people are worse off. This leads to lower levels of consumer spending and ultimately a possible fall in sales for businesses.

Even if your products do not rely on disposable income, there is no guarantee that faced with a cold price increase your customers will not look to an alternate supplier. Whether that be cheaper, lower quality products to support them in the interim, or changing their ingredient mix to reduce the demand for your product, the risk is real.

Conversely, weathering a cost increase without reviewing prices to customers is something that very few businesses can manage.

Rather, businesses must create a medium-term plan on how these cost increases can be dealt with, remembering to consider the key items below.

PRICING STRATEGY

Prices to customers will need to change, but there are numerous ways this can be achieved. Small but frequent price increases may at first seem appealing. However, increasing your prices several times in a short period can force customers to look at alternative suppliers, as they see no end to such increases. It is therefore not unreasonable to ensure that whatever increase you incorporate can be maintained for at least 6 months.

You may also have some products that deliver larger margins, and those are the ones that you need to concentrate on, rather than letting this margin erode to support cost increases on lesser margin products. Remember, even if products are still making profits, a 1-2% movement on gross margin is a significant hit to the business's bottom line.

QUALITY

Now is the time to impress upon your customers the quality of the product you are offering and the service you provide. Customers may approach you with stories of suppliers offering lower costs, leading to a desire to cut corners to remain 'competitive'. However, depleting quality can have an impact on business reputation for years to come, and existing customers may yet return once they realise that lower costs often equate to lower service and quality. That being said, you must be sure your business can deliver exceptional quality if you make this part of your strategy.

COST REVIEW

Offering a quality product or service at an increased price does not mean that internal costs should not be reviewed. Is the business incurring costs simply because it has historically? Is now the time to review energy suppliers or approach your other key suppliers to see if costs can be fixed for a number of months to provide some surety?

It is unlikely that suppliers will approach you directly, conversations will need to be had and research performed. It is also always worthwhile reviewing any manufacturing processes to see if there are ways of reducing wastage and increasing productivity, whether that be by investing in new machinery (see our article on capital expenditure) or adjusting shift patterns and assessing controls.

COMMUNICATION

Of key importance in the current climate is your relationship with your suppliers and customers. All businesses will be incurring and attempting to pass on price increases. Do not be afraid to build on the relationships you have and hold the difficult conversations, it may just make the difference.

CASHFLOWS

The above considerations are vital, but unsupportable unless you can easily assess their impact on your business. Inflation will not just influence your profit margins, it will eat into cash resources as well, as the cost of your stockholding and debtors increases.

It is therefore important for the business to prepare a cashflow projection for at least the coming 12 months, including any strategies as above, to highlight any issues with liquidity, and ensure that the business's financiers are supportive through this period.

At Sowerby we have a dedicated team who provide this help and advice to our clients daily.

If you would be interested in hearing more about the above, specifically in relation to your business, contact your Relationship Partner or Elizabeth Blanchard

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ADVICE AND BEST PRACTICE

CAPITAL ALLOWANCES AND SUPER DEDUCTION

CAPTIAL ALLOWANCES -WHAT ARE THEY?

When a business incurs capital expenditure, that item appears as an asset on the balance sheet of the business with the value of the asset being written off over time through a depreciation expense.

For tax purposes however, depreciation is not an allowable expense. Instead, an alternative set of rules, known as the "capital allowances" regime, dictate how tax relief is given on particular capital expenditure.

It is important to note that not all types of capital expenditure fall under this regime (the most common exclusion is expenditure on land and property) meaning that there can be no capital allowances claims, and so no tax relief on purchase. The rationale is that these type of items tend to appreciate.

WHY DO THE CAPTIAL ALLOWANCES CHANGE SO MUCH?

In recent years the government have been especially keen on changing the capital allowances rules as one of their key 'control dials' on the economy. Attempting to influence businesses to accelerate their capital expenditure, by giving tax relief on it sooner, is one of their favourite tools to stimulate the economy.

It has therefore become increasingly important for businesses to be able to navigate these rule changes, especially as they grow more complex. Businesses that correctly plan their expenditure will get tax relief a lot sooner than those who don't. Tax bills could potentially be reduced by huge sums now, instead of waiting decades to eventually get that same tax reduction, by efficient capital expenditure planning.

HOW SHOULD BUSINESSES TIME THEIR EXPENDITURE CORRECTLY?

Historically, the key concern for most businesses has been to avoid exceeding their Annual Investment Allowance (AIA). If qualifying capital expenditure falls within this allowance then it can be deducted in full for tax purposes in year one. Expenditure not in the AIA gets tax relief much slower over a number of years

However, there are a few reasons this might be trickier than it seems:

- The level of this allowance has fluctuated quite wildly over the last few years – from £25,000 to £1m.
- A business likely has a year-end for its accounts that doesn't align with the dates these limits change. Where there is a transition between limits, the rules can be complex.
- A business might have to share its AIA allowance with other associated businesses.
- Not all expenditure qualifies for AIA – most notably cars (commercial vehicles are ok).
- Conversely, certain types of expenditure can also be deducted in full, without using the AIA - for instance fully electric cars.

The AIA limit is currently £1m. As announced in the October budget, this limit is to stay in place until March 2023.

WHAT IS THE SUPER DEDUCTION?

On top of the existing capital allowances rules, the government recently announced an additional incentive to encourage further capital expenditure. This incentive has been dubbed the 'Super Deduction' since it gives £1.30 of allowable expenditure for tax purposes, for every £1 of real world expenditure. It's therefore 30% more valuable than expenditure that would otherwise fall within the AIA. Plus, there is no cap on the amount of Super Deduction claims that can be made – so many businesses may not even use their AIA while the Super Deduction is available instead.

As with all tax rules, it's important to note the details:

- It's only available to companies (not sole traders or partnerships).
- As with the AIA, it doesn't apply to all capital expenditure – for instance cars are excluded.
- It only applies to expenditure on brand new plant and machinery, not second-hand items.
- It's only available between 1 April 2021 and 31 March 2023.
- If the item purchased is sold in the qualifying period, the extra 30% boosted allowance will be reversed.

DOES THIS MEAN THE TIME TO INVEST IS NOW?

On one hand, the tax breaks for capital investment are currently more generous than they have ever been, with the higher AIA spanning until 2023, and for companies, the Super Deduction further increasing deductions.

However, for some companies in particular, there is a hidden surprise around the corner that actually means the Super Deduction might not be as good as it initially appears. The corporation tax rate is increasing in April 2023 to a maximum of 25%. Companies paying this full rate would, effectively, get the same amount of tax savings if they incur expenditure after April 2023 that qualifies for the AIA, when compared to expenditure made before April 2023, which qualified for the Super Deduction. In other words, while the Super Deduction is generous, for some companies it may not actually provide quite as big an incentive to accelerate expenditure as it first seems.

As this article illustrates, ensuring a business makes the most of the capital allowances regime can require careful consideration of the rules, and timing of expenditure. Depending on the amount and type of expenditure, business size and structure, and even year-end date, the advice will be different each time.

We are on hand to review how you can secure the maximum tax benefit from these rules as early possible.

For more information, please contact your Relationship Partner or James May our Tax Manager.

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SOWERBY

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It's been a busy quarter for the Sowerby team, with the prime event of the last few months being our internal training conference, which took place in Harrogate. Being a three-day affair, this is a yearly activity that Sowerby have undertaken for the last ten years after coming to realise that external Professional Development courses were no substitute for bespoke courses especially designed for our staff.

This year's conference covered an auditing and tax update, with one central topic being a refresh of new tax rates and the current super deduction which we cover in the advice section of this newsletter, an update on current insolvency frameworks from Kingsbridge Corporate Solutions, and a discussion of funding solutions for clients from Custom Business Finance.

Our conference is not just about technical skills however, and Doughty Consulting joined us to give a talk on personal development and mental wellbeing before our team building challenges began, which saw our very own Mike Bolton leave as Conference Champion 2021.

In a slightly stormier environment, the Sowerby Three Peaks team also successfully completed their 24-mile overnight hike over the Yorkshire 3 Peaks, raising an impressive £10,206 for Macmillan Cancer Care at the time of writing. Sowerby would like to say a huge thank you to all who donated and supported us with this challenge.

Finally, we end the quarter by welcoming three new staff members. Emily Moulton and Gayle Pitter join us as permanent members of our Accountancy department and Sinem Ozer has joined us as an intern for the third year of her Accountancy degree as part of our on-going relationship with Hull University. We look forward to seeing their careers progress with Sowerby.

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