EXIT STRATEGIES

THERE'S A LOT TO CONSIDER WHEN YOUR BUSINESS IS ON THE MARKET.

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There comes a time in every company's lifecycle where the decision has to be made whether to sell the business. This turning point can be due to several factors – lack of proper management team to continue the business, lack of a younger familial generation to take over or outside competitive or financial pressures. There are several important practical considerations to address when going through this process.

PREPARING TO SELL

Selling a business is like selling a house – you must prepare it for the market. It takes time, teamwork, research, planning and commitment. At the beginning of the process, you should:

- ❑ Have a written agreement to document your decision to close.
- ❑ Assemble a team of professional advisors such as accountants, lawyers, a business broker and bankers.
- ❑ Get professional help to evaluate and price your business. An independent valuation is generally one of the most reliable methods of establishing a market value. Another option is to seek out your industry trade association for industry specific valuation services.
- ❑ Physically prepare the site such as repairs and deferred maintenance.
- ❑ Ensure that financial and corporate records are up to date. Address any issues existing in internal systems for accounting, performance reporting and internal controls.
- ❑ Make sure that all tax returns (income, payroll, sales and use) are filed to date and all taxes are paid.
- ❑ Be informed on filing of proper dissolution documents, canceling registrations, permits, licenses and business names.
- ❑ Plan to notify your creditors, employees and customers.
- ❑ Identify potential buyers and plan a marketing strategy.

BUYER DUE DILIGENCE

Several documents will assist the buyer in completing due diligence process:

- ❑ Non-disclosure agreements to be signed by potential buyers.
- ❑ The company's articles of incorporation, good standing certificates, bylaws, list of shareholders and minute book.
- ❑ Copies of the past three years' income tax returns, sales tax returns and employment tax filings.
- ❑ Detailed financial statements for the last three years.
- ❑ Monthly management reports and profit and loss information for purposes of net working capital calculations and quality of earnings calculations.
- ❑ Leases, deeds and mortgages.
- ❑ List of physical assets and approximate values and equipment leases.
- ❑ Valuation of inventory.
- ❑ Copies of any licenses, permits or franchise agreements, if applicable.
- ❑ List of any intellectual property like patents, trademarks or copyrights.
- ❑ Copies of contracts.
- ❑ Any environmental issues.

TAX STRUCTURE

Business owners should meet with legal and tax professionals before a sale to discuss tax strategies for making the company attractive to buyers, while minimizing their own tax liabilities. Taxes on the transaction will depend on two factors:

1) How your business is set up legally. The form of the seller's organization is important to consider. In a C Corp sale, the gains are subject to double taxation. An S Corp or LLC sale results in gains being taxed only once as the income or losses of these entities flows to the shareholders.
2) Selling assets versus company stock. Buyers generally prefer asset sales and sellers generally prefer stock sales because of tax structures.

Treating a sale of a business as a stock sale is made as a tax election with a range of additional requirements. Consult your tax professional.

OTHER TAX CONSIDERATIONS

It is important to clearly define in the purchase agreement the responsibilities of the buyer and the seller, specifically who is responsible for preparing and paying for the tax returns pre- and post-sale. The individual seller should also consider the following items as the sale moves toward its conclusion:

- ❑ The gain on the sale may be considered ordinary income (subject to the highest tax bracket, 39.6 percent) or capital gain (20 percent) or a combination of both rates. If there is depreciation from fixed assets, then there will be a depreciation recapture tax of 25 percent.
- ❑ Any passive losses or at-risk losses from this business that have accumulated will be released in the year of sale, which can help to offset the overall gains and other income.
- ❑ Additional charitable contributions can be made any time before the end of the calendar year for the year in which the sale takes place.
- ❑ Consider prepaying the state liability before Dec. 31, provided that the taxpayer is not in the Alternative Minimum Tax.
- ❑ While not an income tax savings measure, the seller may contemplate making gifts up to $14,000.
- ❑ There also are many different trust instruments that can be employed to shift the wealth to a different family member or generation.

Selling a business can be daunting task, but with the proper planning, adherence to best practices and guidance from business professionals, it can be smooth. ❑

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