Considering a Change?

Strategies For Owners Selling Their Business

Almost every business owner or successful entrepreneur comes to the decision point of selling their business and turning their risk and responsibilities to someone else. Selling your business is a complicated process that not only demands preparation and planning, but also requires an understanding of the tax implications you may face depending on how the sale is structured.

There are **four major steps** to follow once you've decide to sell your business:

- ➔ Outline your exit strategy
- ➔ Price your business correctly
- ➔ Prepare your selling package
- ➔ Negotiate professionally

OUTLINE YOUR EXIT STRATEGY

Planning to exit from your business often involves more than just closing the doors. Exit strategies are a key component of business plans; they summarize the goals for selling your business and clearly articulate the timeline for achieving these goals.

Every successful exit strategy has three common objectives:
1) A clear, targeted result;
2) A consensus on the owner involvement, post-exit; and,
3) the timing to achieve the exit.
These key objectives are vital to implementing an effective strategy to exit from your business.

A key component to the exit strategy will be identifying the team that you'll need in place to assist with the sale of your business. Professionals such as business brokers can help with finding potential sellers, valuation analysis can provide an appraisal of your company's worth, and a qualified CPA firm can facilitate the review of all financial documents and outline the tax consequences of your sale. Professional expertise and advices in these arenas will contribute to a smooth process and help you obtain your exit strategy goals.

PRICE IT RIGHT

Before entertaining any offers, you must find out what your business is worth in the market. According to a study by *Business Week*, barely half of all owners have done a formal valuation of their business.

The sale of your business isn't simply the sale of one asset, but rather the sale of all the assets of the business. These assets must be reviewed, classified and documented. In order to accurately evaluate your company's assets, expect to produce several years worth of financial statements and be prepared to explain them in great detail. Preparing a list of assets and performing a physical inventory is an important step in establishing the value of the business and becomes the basis for tax calculations and tax returns as you move forward in the sales process. In many cases the value of your company will boil down to the current and expected cash flow – earning before interest, taxes, depreciation, and amortization, minus any capital spending necessary upon purchase of the business. Buyers like to see cash flow projections five years out; as the seller, you may want to use those projected earnings to set a price that guarantees a decent return for your buyer.

Certain intangibles will also impact the value of your business; your workforce, brand value, intellectual property, and overall company goodwill can affect how a potential buyer sees your organization. Completing the assessment of these types of company strengths not only organizes information, but can also uncover strategic advantages that can be leveraged when it becomes time to begin negotiations.

PREPARE YOUR PACKAGE FOR POTENTIAL BUYERS

Comprehensive documentation is essential to selling your business. That means you have to develop a convincing package to present your business. Buyers will expect to have accurate and current financial reports and that you will provide a detailed analysis of your business; however, buyers will also expect you to be able to justify your price and terms based upon their desire for a return on investment.

Although everyone likes to say we're in a paperless society, it's still amazing how much paperwork will be required when preparing to sell your business. Here are some of the documents you may need:
- Executive summary of your business
- Detailed profile of the business
- Internal profit & loss statements
- Up-to-date balance sheets
- Corporate tax returns
- Insurance policies
- Client and supplier contracts
- Employment agreements

During the various stages of the sales process the buyer may request documentation that will be highly confidential. Be upfront with them about any hesitations and consider having them complete a confidentially disclosure. Try to avoid derailing the sale, and understand that a buyer will need a reasonable about of information to give you an offer.

NEGOTIATE PROFESSIONALLY

Terms drive price, and you should arrive at an understanding about the major terms before you start talking dollars. You may even include a short list of your absolute requirements as part of your sales packages to potential buyers. Holding preliminary conversations with potential buyers helps to arrive at a general agreement; however, you should consult with your attorney, CPA and broker to be sure that you understand all of your options.

When you sell your business you're likely to face a hefty bill from Uncle Sam. In fact, if you're not careful, you can wind up with a lot less in your pocket after all taxes are paid!

Paying taxes on capital gains is a requirement. If you are a sole proprietorship, a partnership, or an LLC, each of the assets sold with the business are treated separately. The problem becomes one of allocation:

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if you negotiate a total price for your business you and the buyer must agree as to what portion of the purchase price applies to each individual asset, including intangible assets. The allocation will determine the amount of capital or ordinary income tax you must pay of the sale.

In the case of corporations, you have the option of structuring the sale as a stock sale or you can sell the assets and keep the corporate "shell" in your hands. With the asset sale, you could be taxed twice: once the assets are sold and when the shareholders pay gains on the liquidated corporation. In contrast, if you sell the stock, you'll pay taxes only on the profit form the sale; generally at the 15% long-term capital gains rate.

That's the basic story, but with the IRS nothing is ever simple. There are a number of variables that can present tax issues to owners getting ready to sell their business:

- Installment Sales: If you defer receipt of the purchase price to later year with installment sales, you may be able to postpone paying tax on your gains until you receive them.
- Tax-free reorganizations: where one corporation is buying another you may be able to structure the sale as a tax-free merger.
- State tax issues: In some state, sales tax may also apply to asset sales.

With as much as 90% of the sales of small businesses involving some level of seller financing, it may be unrealistic to expect a lump sum payment for your company. Yet, financing can be tricky and pose a potential risk. Consideration should be given to how much you really need to receive at closing, how much you will remain involved in the business after the sale, and how tax considerations will affect your outcome.

The sales agreement is the key document in buying business assets. It is important to make sure the agreement is accurate and contains all of the terms of the purchase. It is a good idea to have your attorney review the sales agreement prior to officially signing off. You'll want to ensure that everything you're intending to sell – the assets, customer lists, contracts, property – are listed and completely defined. Also consider any non-compete agreements and contingencies.

CLOSING: AFTER THE SALE…

After the sale of your business is negotiated and the sales agreement signed, there will be some final "loose ends" to tie.

1. Conclude all contract obligations. This process may require approval from contracting parties and possible renegotiation with the business' new owner. Office space, company cars, and leased equipment need to be reviewed, addressed and terminated.

2. Dispose of and transfer assets. This is an important tax event – settle accounts payable and all debt obligations.

3. Prepare final financial statements and tax returns. Final financial statements for the business are important to establish the tax implications for assets, gains, and losses.

4. File articles of dissolutions with any state licensing departments to ensure your business is legally terminated or transferred from your name. This process also results in the review of tax liabilities.

5. Prepare final submission of payroll, unemployment, industrial insurance and other business taxes to indicate that the business status is changed or closed.

When it comes to business, how your exit is just an important as how you enter. The goal is to maximize the value of your company before converting it to cash and minimize the amount of time consumed in the process. These activities can require the same amount of planning as going into business. The best advice is to think about the process early and engage the right team to help from the start.

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For assistance getting started, contact our small business advisor, Thomas Jones, CPA, at 713.968.1600.

ABOUT MJLM

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