

Factors to Consider When Selling Your Business

Successful business executives have most likely devoted years to building their companies. Yet, at some point, they may contemplate retiring or changing direction. If selling your business is an option on the horizon, there are a number of important factors to consider in ensuring a successful and profitable sale.

Creating Market Value

One of the first questions to ask is, "Who are the potential prospects for my business?" Likely candidates may include larger companies or competitors. However, too often, private businesses are sold through business contacts or as a result of direct approaches made by potential buyers. While an unsolicited proposal is flattering to receive, such chance opportunities may not yield the highest value.

Another possibility is to sell the company to employees through an **employee stock ownership plan (ESOP)**. ESOPs are defined contribution plans and are subject to the same guidelines imposed on 401(k) and profit-sharing plans.

Although ESOPs give all employees a vested interest in the company's profitability, they can also function as a private marketplace, enabling a retiring business executive (or employee) to recognize a retirement benefit by selling his or her shares back to the ESOP. In some circumstances, the executive may also be able to defer gain on the sale of stock to the ESOP.

When actively seeking a buyer, it is also important to keep in mind that there are some actions you can take to increase the value of your company. Just as banks lend more readily when business prospects are good, buyers are more receptive to companies just ending prosperous years.

By planning to sell when your company's performance is good, you can greatly influence buyer interest and the value generated in the marketplace. This can ultimately help you negotiate the highest sale price and draw the right buyer from among the parties bidding on your business. Only by meeting with a host of potential buyers can you weigh the relative merits of each proposed offer.

Consider Tax Effects

Review the net after-tax effect of any proposed transaction with care. The tax consequences of an **asset sale** are quite different from those of a **stock sale**. The accompanying chart illustrates the impact of these two different scenarios, along with a "compromise" option—a stock sale at a reduced price.

Suppose Jack Flynn founded Flynn Chemical Company, a "C" corporation, in 1980 with \$100,000 of personal capital. Today, Flynn Chemical Company is worth \$1,000,000 and Jack has decided to sell his business. Jack has an interested buyer, but he is unsure whether to liquidate his company's assets (Option A) or to sell his stock outright (Option B). The chart below shows the result of both methods.

Keep in mind, that it is also not uncommon for negotiations to result in a compromise. For instance, Jack may decide to sell the stock to the buyer at a reduced price (Option C). Jack's proceeds will still be substantial—more than if he had sold the assets outright—and the buyer's concerns about not receiving a step-up in basis for the acquired assets will, more than likely, be outweighed by the reduced sales price.

	(A) Asset Sale	(B) Stock Sale	(C) Stock Sale at Reduced Price
Gross Value of Flynn Chemical Co.	\$1,000,000	\$1,000,000	\$1,000,000
Jack Flynn's Basis	\$100,000	\$100,000	\$100,000
Sale Price	\$1,000,000	\$1,000,000	\$850,000
Gain to the Corp. on Asset Sale	\$900,000	---	---
Corporate Income Tax @ 34%	\$306,000	---	---
Gain on Redemption*/Stock Sale**	\$594,000*	\$900,000**	\$750,000**
Capital Gains Tax @ 20%	\$118,800	\$180,000	\$150,000
Net Proceeds to Jack Flynn	\$575,200	\$820,000	\$700,000
Buyer's Basis on Acquired Assets	\$1,000,000	\$1,000,000	\$1,000,000

Note 1: With an asset sale, in addition to the \$900,000 gain to Flynn Chemical Co., for the amount received over the corporation's basis in the assets, there may be a gain to Jack Flynn as an individual taxpayer upon liquidation of the business.

Note 2: This example is for hypothetical purposes only. It is not intended to portray past or future investment performance for any specific investment. Your own investment may perform better or worse than this example.

Personal Planning—Front and Center

Regardless of which option you decide to pursue, your initial efforts should focus on a close examination of your personal planning needs and concerns. If you are like many business executives, you have probably had little time to devote to your personal financial and estate planning needs.

In addition, you could be holding a compensation package that contains benefits that are not portable. Other benefits, such as deferred compensation, may not be available for your current use, while some benefits may become available only upon retirement or death.

Because much of your worth may be tied up in your company's stock, it is important to review the proper tax, estate, and financial planning issues prior to the actual sale of your business.

Now may be a good time to meet with your financial service professional to minimize any tax liabilities, and to help guide you over the potential legal, tax, and accounting hurdles that may arise. Intermediaries can help you set realistic goals, sort through potential buyers, negotiate with interested parties, and select the most advantageous offer to ensure the maximum future benefit for you and your family.

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