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Preparing Your Business for Sale

At some point, the lucky entrepreneur is able to realize the fruits of her success and ride off into the sunset after the momentous occasion of having sold her business. But, the path to the sale is a complicated one. Preparation is essential. Too often, the seller pencils out a deal to sell her business with a prospective purchaser without ever getting her metaphorical house in order. Then, when the seller goes to the lawyer to draft the deal (and wants to close next Friday) the deal is not anywhere close to where it needs to be to move to drafting. The key is to visit with your attorney early to prepare for the sale before entering into sale discussions. Here's some of the important considerations:

Get your company organizational books (the legal side) in order. Most companies will be entities (corporation or limited liability company). You should have on hand all of the organizational documents. For a corporation, this includes the Articles of Incorporation, the Bylaws, the Organizational minutes and the annual minutes. For an LLC, this includes the Certificate of Formation, the Operating Agreement, and any annual minutes. Check the correctness of the documents. Who is listed as the officer or director or manager? Does that match the current company profile? Does that match the people listed on the Secretary of State Web site? All these facts and records should match.

Clarify Ownership. For many small businesses, the stock seems irrelevant. For an outside party, it is crucial to understanding the players in the business. Locate your stock or unit certificates. Check the stock transfer ledger. If either the stock certificates can't be found or the transfer ledger is not up to date, then the company should fix the record: issue the correct stock and update the transfer ledger. For most small companies, I think it is best to keep all the stock certificates in one place with all the other original organizational documents of the company.

Get your books (accounting) in order. You should have at least the last three years of financial statements readily available. And, you should maintain balance sheets for the same period. In addition to the past three years, you should also expect to provide updated quarterly reports concerning the same information. The buyer will also likely want to see the past three years of tax returns.

Become familiar with your sale options. At the outset, you should learn the different options for how your business could be sold. The top three sale options follow: First, it could be structured as a stock purchase agreement where the buyer purchases 100% of the stock of the company. This is usually preferable by the seller as it can simplify the transaction. On the buyer's side, the buyer is taking on all the assets but also the liability associated with the business. The second way is through an asset sale. In an asset sale, the buyer does not buy the stock but rather purchases the assets of the business. This allows the buyer to pick and choose the assets he or she purchases and to leave everything else (read: liability) with the company. To the public, the distinction is not evident as the buyer also usually buys the business name and all associated intellectual property and intangible assets. The buyer usually prefers the asset sale as the buyer picks the assets he wants and gets to use the sale price as his tax basis for the assets for depreciation purposes.

A third, more advanced technique, is a sale through the exchange of stock. This is more often used when a large or publicly traded company acquires a smaller one and is more appropriately termed a tax-free reorganization. It looks like a stock sale, but the purchase price is paid with the buyer's stock. On the upside, this transaction can qualify as a tax-free transaction (no tax due upon sale from the seller) and the buyer need front no cash (just stock). On the downside, the seller will be a stockholder in the buyer's business and subject to the potential price fluctuations in that stock (though some of the price fluctuations can be mitigated with put and call combination sometimes called a "collar.")

Be prepared to disclose (and warrant) an exhaustive list of information concerning your business. The buyer will not only want to thoroughly examine your business and your books, but will also want the seller to make certain representations or promises about the business. [I suggest: And any misrepresentations could result in seller liability. And, if the seller misrepresents any of the representations, it could be grounds for liability.] Some of the typical representations might include the following: (1) That seller owns all the shares of stock of the company; (2) Seller warrants the financial statements and balance sheets; (3) that there are no liabilities of the company except as disclosed in the sale documents; (4) that the company has all necessary licenses, permits, and governmental authorizations to conduct the business; (5) that seller knows of no claim or lawsuit pending or threatened against the company; (6) that seller has paid all of its taxes; (7) that seller has no employment claims; (8) that seller owns all the tangible and intangible assets; and potentially many (many) more.

Know and document your business relationships. Know all your customers (customer lists), your vendors (vendor list), and any contracts you have in place and whether they are personally guaranteed (by the owner or the company) or not.

Financing the Deal. In any deal other than a cash transaction, the seller will be providing some degree of financing. And, it is typical that the seller receives some kind of security (collateral) to secure the payments due. The assets of the business can be used to secure the payment. But, so can other assets of the buyer. It is important to have a working understanding of the collateral options you have to secure your payments.

While potentially time-consuming, challenging, and expensive, careful planning with a qualified professional can help ensure that your ride into the sunset is indeed a momentous and carefree occasion where you are able to enjoy the fruits of your labor.

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