Taxes
On the Sale of a Business

Increased Price – Better Odds

Assisting in your Journey to a Successful Exit

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Why a Buyer wants an Asset Sale

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- Assets repriced and re-depreciated
  - A "Step-up in basis" of assets
  - Depreciation of fixed asset can significantly help future cash flow
  - Amortization of goodwill and other intangible assets also helps cash flow (15 year schedule)
- Unknown liabilities not inherited with corporate entity

HOWEVER:

- All contracts need to be assigned / novated

Asset Sale Tax Summary

1. Purchase price negotiated
   - (Usually based on EBITDA, with taxes and other items in mind)
2. Purchase price allocated to various tangible assets
   - E.g. Inventory, AR, fixed assets
   - Each asset class has its own tax attributes
3. The residual (un-allocated) is assigned to Goodwill
   - Which is long term capital gains - good

Inventory

- No Tax due at sale
  - No gain, no tax
  - Assumes allocated at cost

Accounts Receivables

- No Tax due at sale
  - You already paid tax on the AR
  - Assumes accrual basis
  - If cash basis (rare for middle market), then taxed as ordinary income

Cash

- No Tax due at sale
  - No gain, no tax
  - Allocated at face value

Fixed Assets

- Taxable gain = allocated price less book value
- Ordinary tax rates apply to extent of depreciation recapture
- Remainder of gain is capital gains

Fixed Assets: Depreciation Recapture

- Depreciation Recapture
  - Is the recovery of prior depreciation when a depreciated asset is sold for a gain
  - Gain is tax at ordinary income up to the amount of the depreciation
- See spreadsheet for example

Fixed Assets Allocation

- Seller wants low price, buyer wants high price, IRS doesn't much care
- Fair market value is simple way to allocate
- However doesn't have to be FMV
- Negotiable

Liabilities Assumed

- No Tax due at sale
  - For tax purposes, purchase price is assets less liabilities
  - i.e. Allocation is done after deducting payables, etc.

Goodwill (and other intangibles)

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- Residual, or everything left over after allocating to other assets
- Taxed at Capital Gains rate
  - Also applies if allocated to customer lists and other intangible assets

Consulting / Stay-on Bonus Agreements

- Taxed at ordinary income
- Also employment taxes
- Buyer greatly prefers this, gets immediate write off
- Much better to take this consideration truly as part of the purchase price
- *Note: No agreement can force you to stay employed*

Non-compete Agreement

- Taxed at ordinary income
  - Think of it as wage-replacement
- Buyer gets 15 year amortization
- In many states some value needs to be assigned in order to be enforceable

Examples of Allocation

- See spreadsheets for Examples
- Natural Buyer/Seller conflict on allocation
  - Buyer wins, seller loses, IRS wins
  - Seller wins, buyer loses, IRS wins
- However buyer and seller must report on IRS form 8594 so IRS can verify it won
- Form 8594 is in Supplemental materials

Deemed Asset Sale 338(h)(10)

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- S-Corp only
- It is a stock sale
  - Contracts and agreements more easily handled
  - Undisclosed liabilities still an issue with buyers
- It is an asset sale only for tax purposes
  - Must do allocation of purchase price
  - Depreciation recapture applies

Stock Sale Taxes

- Gain = Price of stock less cost basis
  - C-Corp, cost is straightforward
  - S-Corp & LLC, cost basis is tracking inflow and outflows of capital