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How to pay too much income tax on the sale of your business.

Yes. There are ways to pay too much income tax on your business's sale. The sale could be your biggest windfall or not.

How does the seller pay too much income tax on the sale? If the owner does not properly value the assets sold or incorrectly allocates non-capital and capital assets sold, he could pay too much income tax.

Most small businesses are sold as asset sales rather than stock sales (the sale of the stock in the corporation), because many buyers of small businesses want the benefit of depreciating the assets purchased such as equipment, software, and other assets that they acquire. In a stock sale, the buyer can not benefit from depreciating assets acquired through the purchase.

In an asset sale, the purchaser buys the assets of the target company. There is negotiation on which assets the buyer will purchase. The asset sale is not always an advantage to the seller, because the seller will pay ordinary income tax on non-capital assets sold and pay capital gains tax on capital assets. It is important to allocate properly the assets sold for tax planning. In most scenarios, ordinary income tax is much higher than capital gains tax. The seller and buyer will need to go through an analysis / allocation of the assets in the sale.   The analysis is commonly referred to as the Purchase Price Allocation. Here's an example:

Joe sells his nursery for $3 million. The terms of the sale are that the buyer will pay 1/3 deposit for the assets in the business and requests Joe to finance the remaining 2/3 over 3 years. The seller has a commercial line of credit with a balance of $50,000 at time of purchase agreement and no other liabilities. In many asset sales, liabilities are excluded from the agreement. Buyers wish to avoid taking on seller debts and are interested in depreciating assets purchased to enjoy the tax deductions of assets purchased. This example presumes that the agreement excludes the seller's liabilities.

The Purchase Price Allocation begins with computing the assets purchased at the time of the sale. The cost or book value of assets in this example are the total assets purchased. The next step is to have a fair market appraisal of the physical assets that are sold including equipment, furniture & fixtures, inventory, and it may or may not include

accounts receivable. In many asset sales, cash may be excluded or partially included to allow the buyer working capital needed to continue the business effectively.

After an appraisal of the fair market value of the assets, the final analysis is to determine the Goodwill, computed by taking the agreed upon purchase price less the fair market value of the assets purchased: In this example, the Purchase Price Allocation will compute the enterprise's selling price of $3 million less the fair market value of the assets. Let's presume the fair market value of the physical assets are composed of inventory of $500,000, and equipment of $1,000,000 totaling $1,500,000. The Goodwill is $1,500,000. The allocation for tax purposes would be as follows:

1) Inventory of $500,000 will be taxed at the ordinary income tax rate of 35%

2) The equipment of $1,000,000 will be taxed at capital gains rate of 20%

3) The Goodwill of $1,500,000 will be taxed at capital gains rate of 20%.

It is best to have adequate methodology and documentation from independent appraisers. They are essential to manage the income tax impact on the seller and protecting the seller from a negative outcome from a possible IRS audit with regard to the Purchase Price Allocation. Both the buyer and seller need to agree to the allocation and the best practice is to use an independent professional to prepare the Purchase Price Allocation, because both parties need to submit the allocation on their tax returns. The IRS has audited these allocations in sales of businesses, thus it is best to obtain professional assistance in planning the sale of your business and avoid traps in preparing these allocations.

Consider these marketing priorities to grow your profit.

Improving your marketing outcomes are critical to increasing profit and freeing time for business owners. Marketing productivity includes using five essential marketing priorities:

1. Market first to your existing customers and clients
2. Market second to people who have been your customers
3. Market third to people who have thought about being your customer (showed interest but did not join for one reason or another)
4. Market last to new customers
5. Another method is to market to referral sources who are champions of your products and services. Champions are your sources who know your business well and are excited about your company and its services.

Common industry norms for marketing are to focus efforts on new customers. New customers have not met you or your business. In order to win their business, your business will need them to know your products/ services, like them and trust that you can take care of their needs. Consider using the noted priorities above in your marketing plan to improve your marketing success. Marketing to new customers, many times, is the most expensive campaign with the lowest success rates. It is important to market to new

customers and it's also important to monitor expectations of each of the noted tactics to best use cash in growing your business.

For businesses that have a sales team fleet, fine tuning your commission structure for optimal performance – make sure you have commission scales that are productive individually and for the company).

Run a contest for your sales and customer service team. It creates excitement and gets them focused on their target numbers.

Have special incentives for team leaders. Somebody has to monitor this program, track results and keep the team pulling in the same direction so get them super invested in your successful outcome.

Note: An important part of a well-oiled marketing machine is to monitor regularly the results of the five tactical approaches described.

Provide incentives for customer retention improvements. This is often overlooked, but it's a real bottom-line cash builder.

Tie it all together with a theme. By making the theme different from the norm, it makes it fresh.

Business Succession is not just the seller's issue.

Many stakeholders, employees, bankers, investors, and customers are all impacted positively or negatively by business owner succession.

The time will come when you want to, or have to, leave your business. The optimal business succession is a process, not an event. To make the transition to the next owner as smooth as possible, and to get the maximum return for yourself, it is best to start planning now. These are just some of the benefits you will derive from early succession planning:

- The business survives the change in ownership/management and continues on as a profitable entity
- You will identify and address family or shareholder issues before they become disagreements and a threat to the business' continuity
- You can minimize tax liabilities and maximize return
- It will ensure an orderly transfer of control and competencies
- The business and future leadership will be ready for the transition

The earlier you start your planning the more exit options available to you. You can, for instance, designate a successor and begin developing their skills to take over when you're ready to leave. Your successor may need to arrange additional financial resources or develop their experience in a certain area before being prepared to take over the business and it could be a matter of years before they acquire these.

First you have to decide what you want to do. Will you sell the business, hand it over to a family member, leave/sell it to an employee, or sell it to the highest bidder? Your decision will be based on a number of factors that include your family situation and the type of business you own.

Many owners have found it can be a mistake to assume that just because the next generation is working in the business now, that they will automatically become the owners and/or managers of the business in the future. They may simply not be interested in taking over the role and would prefer to have the business sold as a going concern. They also might not have the ability to run the business.

You have a wide range of succession/transition options - from giving the business away to selling it outright. Go through the entire range available to you and obtain some information on how the various options could be financed. Set the criteria to be used in evaluating each option. These could include the following:

- Your desire to maximize the value of the business
- The taxation implications
- Disruption to business activities caused by the option
- The need for management continuity
- Costs of the transaction

You are the person best positioned to know the business' core competencies, so gather information on alternatives for transferring and maintaining those competencies to the new owners. Be sure to include timeframes in your evaluations. If you want to sell the business outright, consider some sort of progressive payments or vendor finance. Finding the entire purchase price could be difficult for the purchasers and affect your ability to sell the business. This could in turn lower the amount you eventually receive.

Also, think through the implications for the business of your departure and how this will be dealt with in relation to customers and other key stakeholders. Consider your willingness to stay with the business in a non-executive capacity for a handover period to ensure continuity. As a result of your evaluation, decide on the preferred option. Now you need to prepare a written shareholder succession plan that covers these areas:

- The objectives of all major parties including owner(s), family members and senior team members who may want to acquire the business
- The various options under consideration with pros and cons for each
- The preferred option with details of its implementation including: how the price is to be determined, timing of departure, the ongoing role (if any) of the exiting owner, major tax considerations, and who will have the responsibility for implementing the plan

There are many different professional skills required to successfully transition a business from one owner to another. You will certainly need to talk with your accountant, a lawyer, an insurance agent and, if property is involved, a real estate advisor. Plan early and carefully so that when it's time for you to step aside you can do so knowing that the business will continue, and continue to prosper, under its new ownership.

Regular Pieces

How To Make The Most Of Your Newsletter

Be sure to read each article with the mindset 'How could this apply to our business.' Thinking of it that way will guarantee that you get value. Better yet, take notes as you read and commit to having the ideas implemented by the time the next edition arrives. Also, make copies for each team

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member. To really make sure something positive happens, work with your business development specialist to talk your team through the ideas and how to set a schedule for getting them implemented. We're here to help you get started.

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