# DON’T SELL YOURSELF SHORT: EARLY TAX PLANNING TO MAXIMIZE THE SALE OF YOUR BUSINESS

What part of selling a business is most important to sellers? Most would respond that receiving the highest purchase price is most important.  At first blush, this makes sense. However, sellers often focus on the number of zeros in the purchase price and ignore the fact that paying a large amount of income taxes will effectively reduce the purchase price. *Really*, sellers hope to walk away with the most cash in their pockets, i.e. the most after-tax proceeds. Sellers can maximize their after-tax proceeds by engaging in tax planning early. Too often, sellers lose out on tax savings by not considering the tax consequences of a sale sooner.

Prior to engaging with a buyer, sellers can identify tax opportunities and risks that affect the purchase price through sell-side due diligence. Generally, buyers prefer to purchase assets (as opposed to stock) and will pay a premium to do so. Sellers prefer stock sales to take advantage of favorable capital gains rates. However, a seller could identify early on that its net operating losses (NOLs) create an opportunity that allows the seller to negotiate a higher purchase price in an asset sale with peace of mind that it can offset its gains with NOLs. Alternatively, if a seller can pass on its NOLs to a buyer through a stock sale, the seller could demand a higher purchase price as the NOLs create value to the buyer by reducing the buyer’s future tax liabilities.

Sellers should also pinpoint tax risks that may drive down the purchase price. For example, a seller may discover any of the following in due diligence: failure to file all required income and sales and use tax returns in all required jurisdictions; use of improper accounting methods; poorly designed compensation plans; and failure to comply with local tax laws and transfer pricing methodologies.  Ideally, a seller will identify these issues before a buyer does and correct them before the buyer can knock down the purchase price.

Sellers should negotiate certain “minor” aspects of a transaction earlier. Generally, sellers lose leverage and buyers gain leverage as a transaction proceeds. Sellers would often benefit from negotiating certain terms as early as the letter-of-intent stage of a deal, because these “minor” terms have meaningful tax consequences to the seller. For example, parties usually negotiate purchase price allocation at the very end of a transaction when the seller has much less bargaining power even though the purchase price allocation will directly impact the seller's bottom line. Also, if not negotiated early on, the seller may have difficulty renegotiating the form(s) of consideration used even though the range of possible forms of consideration – cash, debt, rollover equity, escrows, earn outs, etc. – creates a range of tax consequences to the seller.

Overwhelmed yet? Most business owners know that differing overall structures create differing tax consequences when selling a business; however, most do not think about the less obvious aspects of a transaction that could have a meaningful impact on the seller's bottom line. By the time many of these tax planning opportunities and risks are identified, the seller has lost the leverage to make meaningful changes. Sellers should engage early in tax planning and sell-side due diligence if they plan to sell a business. Not doing so could leave the seller with a much smaller effective purchase price than expected.

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