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Costs of Selling Your Business

By Erin K. Tenner, Esq.

I am often asked what the costs of selling a business will be. It is a complex question and will depend on your circumstances, therefore, it is best answered by a conversation among you, your accountant and your lawyer. I suggest all three because even after accountants provide their analysis, I find that clients are often surprised by the real costs. Here are a few things to make sure your advisors are considering in any analysis of the cost of sale of your business:

1. <u>How assets are owned.</u> I occasionally come across a corporation that owns real estate. Selling real property inside a corporation is more costly than selling it outside of a corporation. How much more expensive will depend on how the corporation is taxed. If it is taxed as a C corporation, the corporation itself will first pay taxes on any income and then when net income is distributed, that net income will be taxed again at capital gains tax rates.
2. <u>Taxes.</u> All the different kinds of taxes you will pay on closing:
   a. The most obvious is ordinary income tax on net income, but there will also be ordinary income tax on recaptured income. Income is typically recaptured from three primary sources: 1) depreciation, 2) accounting methods like LIFO, 3) previous 1031 exchanges.
   b. Final payroll, including payroll taxes, vacation pay and any other pay that may be owed to employees will have to be paid on the date of closing for the sale.
   c. Sales tax will be due on the purchase price, or reasonable valuation of, fixed assets sold as part of the transaction minus any basis. You will also have to file your final sales tax return which could trigger an audit and additional taxes.
   d. Final employment tax return will have to be filed.
   e. Final franchise tax return will also have to be filed.
   f. Capital gains tax will be owed on some of the income, like goodwill.
3. <u>Prorations.</u> There are many items that will be prorated as of closing. Make sure they are all included in the analysis. Here are a few:
   a. Real Property Taxes
   b. Personal Property Taxes
   c. Rents
   d. Utilities
4. <u>Additional expenses.</u> At least some of the following expenses of selling are often shared by the buyer and seller, but many can be borne by the seller or buyer alone:

a. Inventory expenses for:
    i. Parts and Accessories Inventory
    ii. Fixed Asset Inventory and/or Appraisal
    iii. Work in Progress and Sublet Repair Inventory
b. Used Vehicle Appraisals
c. Escrow Fees
d. Title Insurance
e. Environmental Reports
f. Building Inspection
g. Survey

5. Interest expense on inventory. When you sell inventory that you have been financing, the buyer will not pay for the interest expense, so you will have to pay that off at closing. It's not as big an issue now given what COVID has done to inventories, but still a consideration.
6. Legal and accounting fees can often be significant given all the final tax returns and legal documents that need to be prepared in connection with a sale.
7. Purchase price reductions. Rebates, incentives, credits and holdbacks are typically deducted from the invoice price of new vehicles, so although they may be included in the amount you have financed for the vehicle, if you have already received them, they will reduce the price of the vehicle that the buyer is paying and may need to be taken into account when calculating what the seller will owe to deliver the inventory free and clear of liens and encumbrances.
8. Vendor contracts. If you have vendor contracts that the buyer is not purchasing, you need to consider the cost of buying out the contract. This will include the flooring loan which usually is for more than inventory purchase price due to interest and #7 above.
9. Loan payoffs. You may also have loans that need to be repaid on assets other than just inventory. If you have prepayment penalties on any of those loans, those also need to be taken into consideration.
10. Manufacturer programs. If you have given site control to the manufacturer, or if you have participated in any program pursuant to which the manufacturer has given you any money, you need to consider whether there is a cost involved in selling as a result of that. Some of those programs require you to pay back all or part of the money you were given if you sell prior to expiration of a certain number of years.
11. Effective tax rate hike. Finally, because of the amount of income you are getting all in one year, there may be a change in your effective tax rate even if your tax bracket does not change. This occurs because your deductions that were previously sufficient to eat up most of the income you typically make, will likely not come close to eliminating most of your income from a sale, so a higher net percent of your income will go to pay taxes than is typical.

The foregoing is not intended to be comprehensive, as each situation varies. Keep in mind too, that there will be some cost in winding down the business, including the cost of obligations on the books that need to be paid after closing. While money will still be coming in because receivables are typically not purchased, the amount coming in may or may not cover the expenses of winding down.

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