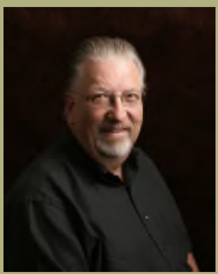
Legacy M&A Advisors LLC

# M&A UPDATE®

September 2015 Volume 10, Issue 9



***Mike Ertel is a Certified M & A Advisor and a Principal Broker with Legacy M&A Advisors, LLC, a full-service M & A Advisory firm with an office in Tampa, Florida specializing in representing sellers and buyers of small- to mid-sized companies. Prior to joining Legacy M&A Advisors, LLC, Mike's business career spanned 30+ years with Fortune 500 and Fortune 1000 Companies, with senior management roles in Marketing, Operations and Logistics. Mike also served as President, COO of a mid-sized Manufacturing company headquartered in Tampa. Mike also holds a BS in Electrical Engineering and an MS in Industrial Administration, both from Purdue.***

## The One Million Dollar Question: Literally in Some Tax Scenarios
**Part 2 of 2**

*Roman A. Basi, MBA/Attorney at Law*
*The Center for Financial, Legal & Tax Planning, Inc.*

**Introduction**

In this month's newsletter, we bring you part II of a two part series discussing the advantages and disadvantages of a stock versus an asset transfer of a company from the buyer's and seller's perspective. While Part I focused on the buyer, Part II focuses on the seller.

When a corporation is sold, the transaction may be structured as a purchase of the shareholder's stock. In a taxable transfer of a business, generally the seller is concerned with the immediate tax consequences. As you will see, in most situations a stock sale yields the most favorable result for the selling corporation and shareholder.

**Consequences of an Asset Purchase to the Seller Corporation**

If the assets are sold, the selling corporation will recognize a gain or loss on the transaction just as they would in any ordinary sale, regardless of whether or not the sale is followed by a complete liquidation of the corporation.

If the sale is followed by a complete liquidation, a second tax to the shareholder will result.

**Consequences of an Asset Acquisition to the Seller Shareholder**

The tax consequences to the shareholders depend on the corporation liquidating after the sale of the assets. If the corporation liquidates after selling the assets, the shareholders will be taxed twice on the transaction. First, the corporation will be taxed on the sale of assets, then the shareholder will be taxed on the sale of the stock; typically at a capital gains rate.

If the corporation does not liquidate, its shareholders do not recognize any gain or loss on the transaction. A shareholder can avoid any shareholder-level gain by holding the stock until death, when their estate will take a stepped-up basis and the stock will be passed on to the deceased's heirs.

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# A CASE STUDY

## Timely Delivery

In a notice, the IRS updated its "Timely Mailed Is Timely Filed" rule. The IRS added FedEx First Overnight, FedEx International First Next Flight Out, FedEx International delivery, and UPS Next Day Air Early AM. It removed DHL Same Day Service, Next Day 10:30am, Next Day 12:30pm, Next Day 3:00pm, and 2nd Day Service. These were removed because the services no longer exist or modified to no longer conform to the IRS requirements. The full list of services that qualify for the timely mailed rule is charted in Notice 2015-38.

The IRS also points out that each delivery service stores the date recorded in its database only for a finite period, but for no less than six months. Senders or recipients using a designated delivery service can obtain information concerning the date recorded by contacting the designated delivery service. Contact information for each delivery service is available on the company's website.

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In both situations, prior to this year, a gain could be deferred on the sale using an installment sale. However, Congress has since changed this rule to where all the gain on an asset sale will be recognized in the year of the sale. Thus, even if the payments are spread out over a period of years, the corporation is required to pay the tax in the year of the sale.

There are a few other problems that can arise during an asset sale to the shareholders. First, the assets left in the company will somehow have to be disposed of. Second, sellers may have to pay off liabilities not assumed by the buyers. Finally, the seller must recapture the depreciation on the assets the company sold, which will result in higher amounts of taxes paid by the corporation on the transfer.

**Consequence of a Stock Acquisition to Seller**

Stock sales provide the most advantageous result for the seller-corporation and shareholder. This is because the transaction is only taxed once funds are paid.

The shareholder will reduce their basis in the shares to zero and any excess price paid for the shares will result in a capital gains tax that will be paid at the appropriate rate by each shareholder. In the fashion, it is usually recommended to sellers that they sell their stock certificates in the company.

**Conclusion**

As can be seen, deciding if you want to sell assets or stock depends greatly on whether you are the buyer or the seller. If you are the buyer, the asset purchase will be more appealing; and if you are the seller, you would probably prefer to sell your stock. This becomes a key issue in negotiations when one decides to sell their company. If you are interested in purchasing a business or are considering selling a current business, contact the merger and acquisition specialists, at the Center of Financial, Legal, and Tax Planning, Inc. to devise a tax planning strategy that will fill your needs and successfully complete the transaction.

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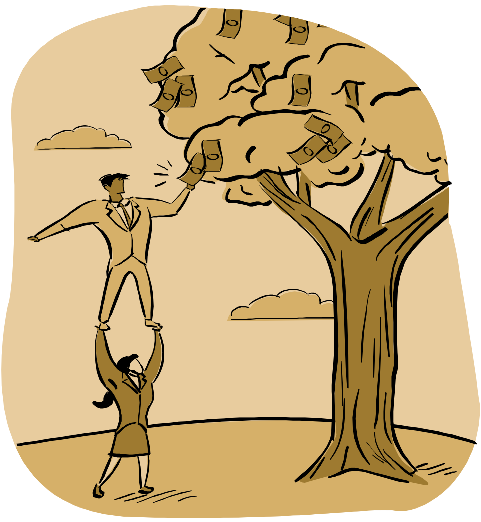
**About the author:**

**Roman A. Basi, President of The Center, is an Attorney, Real Estate Broker, and Title Insurance Agent. Roman speaks and advises The Center's clientele on such matters as Business Law, Succession, Estate & Tax Planning and Real Estate.**

## Points of Interest

- **Generally, the tax consequences are as important as the asking price itself. (from last month)**
- **…in most situations a stock sale yields the most favorable result for the selling corporation and shareholder.**
- **If you are the buyer, the asset purchase will be more appealing.**



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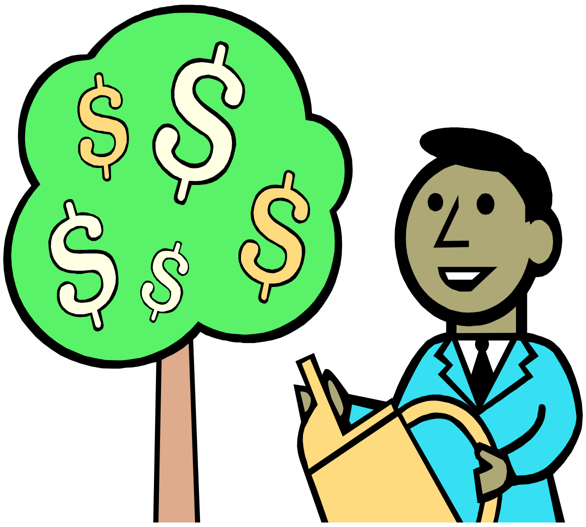
## A CASE STUDY CONTINUED:

**Editorial Comments:**

**While this notice is not a sophisticated merger or acquisition case, I put it here because I want to draw attention to the rule and issues surrounding it. Under the Timely Mailed is Timely Filed rule, taxpayers benefit from being able to file on the last day, but be careful. Not all services qualify. Among the list is USPS first class, USPS registered, and USPS certified. If you choose to go off the list provided, be sure to file well ahead of time.**

**Whenever mailing a federal or state return that is time sensitive, be sure to send the parcel with some form of proof that it was timely sent. The feds and state are not as cautious as they should be when recording the postmark and several people have had to prove their position. It is better to have positive proof rather than no proof!**

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## Role & Importance of Seller Financing in Selling a Business

Almost without exception, all business sellers would prefer to get 100% of their selling price in cash at closing – and for some very good reasons. Most sellers have heard horror stories about other sellers who sold their business for little or no cash down, and carried a seller's note for almost the entire purchase price, and lived to regret it.

Nonetheless, I generally coach my selling clients that they should be prepared to take back a least a small seller's note – perhaps for only 10% of the selling price – if the deal justifies it and the buyer is trustworthy and creditworthy.

Often when the seller insists on getting 100% cash at closing, the buyer, his banker and other advisors, begin to suspect that perhaps the seller knows something is about to go wrong with the business, and is eager to get as far away as possible. This suspicion obviously has a chilling effect on the negotiations.

In contrast, when the seller is willing to carry even a small seller's note, say 10% of the purchase price, the bank is more comfortable, and the buyer and his advisors are more confident that they are not buying a distressed business, and also that the seller will be willing to assist with advice and counsel beyond the typical four week training period, should it be necessary.

One study focused on the impact zero seller financing has on selling price, and concluded that businesses which sold with zero seller financing sold for as much as 40% and 60% less than comparable businesses.

Other studies have shown that 70% of all business sales included some element of seller financing. This percentage no doubt increases during economic downturns and at other times due to the tightening of the credit markets.

This is particularly true of smaller businesses. One study concluded that in over half of all businesses sold, the seller financed over 50% of the selling price. Some businesses which are particularly difficult to "bank," such as construction contractors, may be almost unsalable without significant seller financing.

Another benefit of taking even a small seller's note and treating the transaction as an installment sale for tax purposes is that it may reduce – or at least defer - the seller's total tax burden.

*If you would like to receive a copy of our white paper entitled: **Value Drivers to Maximize the Value/ Selling Price of Your Business**, please contact me directly.*

*As ever, if you know of a business owner who's thinking of selling or buying a business and who might benefit from a **free, confidential**, consultation with us, have them contact me.*


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# Frequently Asked Questions…

**Q: My father died in 1999. My mother passed away last month. Will I have to pay estate taxes based on the value of the estate?**

**A: Generally, the heir does not pay the estate tax. If there is an estate tax due, the estate is responsible for the estate taxes due on the gross value of the estate. This year, the estate tax exemption is $5,430,000.**

**Q: How do I deduct expenses from an estate to arrive at the true value of the estate?**

**A: The estate can deduct estate expenses from the estate itself using form 706 or it can use form 1041 to deduct expenses from the income of the estate.**

**Q: Using a last will & testament, can an estate effectively move a business from decedent to heir?**

**A: It is a really bad idea to approach business succession in this manner. If a business is passed down through a will, it could be subject to probate, a process that takes 6 months or longer. Also, details can emerge in the transition process which are best dealt with during the life of the owner.**