

## SELLING A BUSINESS

### SUMMARY

This BMA is intended to serve as a general outline of the major problems and considerations that typically are involved in the sale of a business. Of course, every potential buying or selling company and every transfer process have their peculiar aspects, both legal and non-legal. And every state has different laws affecting the mechanics of a transaction as well as the rights and liabilities arising from it. Member companies are cautioned, therefore, to consult their own counsel and financial advisors for assistance in evaluating the particular circumstances applicable to a proposed purchase, analyzing the problems or considerations those circumstances entail, and determining the best means for dealing with them. Let your accountant and your attorney each study this checklist; then review it with them. It is designed with the small metalworking company in mind.

### SELLING A BUSINESS CHECKLIST

#### I. Evaluate Buyer's Offer

##### A. Methods of evaluation are:

1. Compare the offer with offers received from others.
2. Obtain a professional appraisal of the assets of the business (see BMAs on Appraisals).
3. Consider how the offer compares with historical earnings, potential profitability, and book value of the selling company. (However, there is usually little relationship between book and market value.)

#### II. Conditions to be Satisfied

##### A. Determine the extent to which federal and state securities laws require disclosure to buyer, stockholders, or creditors.

##### B. Obtain necessary information about buyer

1. Examine buyer's charter provisions, by laws, shareholder's agreements, or voting trusts which might limit the transaction that can be entered into.

2. Investigate buyer's financial status and business reputation.

##### C. Determine effect of state corporation laws on proposed transaction.

1. Need for shareholder approval.
2. Rights of dissenting or objecting shareholders.
3. Duty to notify creditors.
4. Procedures for in proceeds of sale.

##### D. Determine what special authorization or consultation will be necessary from:

##### 1. Government agencies:

- a. Department of Justice or FTC antitrust laws.
- b. Internal Revenue Service tax ruling.
- c. SEC-stock registration requirements.
- d. Any other agency, federal, state or local, which may be concerned with the proposed transaction.

2. Lending institutions.
  3. Other parties connected with the buyer.
- E. Be certain that the prospective transaction will not be upset by significant business changes or long-term commitments made by the seller during the negotiations without clearance from the buyer.

### III. Determine Form of Transaction

- A. Alternative forms of sale:
1. Sale of Stock.
  2. Sale of assets (with or without a subsequent distribution of proceeds to seller's stockholders).
  3. Statutory merger or consolidation (with buyer or buyer's subsidiary).
- B. Factors to consider in choosing form of transaction.
1. Possibility of contingent and/or unascertained liabilities. (These are more easily transferred in a stock sale or merger.)
  2. Objections of minority shareholders. (The rights of minority shareholders of either the seller or the buyer to delay or block the transaction and/or to be paid off will vary according to the form of transaction chosen. Each state law differs on this point.)
  3. Relative desirability of alternative forms in the minimization of taxes.
    - a. Possibility of avoiding present realization of gain through use of special tax reorganization provisions. (Seller must be willing to take stock in payment.)
    - b. Problem of realizing ordinary income on an asset sale by reason of depreciation recapture, restoration of bad debt reserve, recapture of investment credit, realization of income on piecemeal inventory disposition, etc.
    - c. Problem of realizing gain on sale of assets and second gain on disposition of proceeds to seller's stockholders unless special liquidation of procedures are followed. (Conversely, if asset sale produces a loss, it may be advantageous to deliberately avoid these special procedures.)

- d. Advantages and disadvantages of retaining old corporation after a sale of assets to avoid gain on distribution of proceeds, make use of loss carryovers, etc. (Consideration must be given to tax limitations governing the operation of investment companies.)

4. Need to expedite transaction. (Depending on the circumstances, one form of transaction may be much more expeditious than another.)

### IV. Determine Form of Receipt

- A. Alternative forms of receipt:
1. Stock of the buyer's company (preferred and/or common.)
  2. Cash.
  3. Bonds, convertible debentures or debt obligation of the buyer payable in future installments.
  4. A combination of the above, perhaps with a provision for contingent payments based upon future earnings of the business.
- B. Factors to consider in choosing form of receipt:
1. Need for immediate liquidity.
  2. Buyer's credit rating.
  3. Future earnings prospects of buyer.
  4. Present and future marketability of buyer's stock.
  5. Desire to postpone income tax on transaction. (Payment in common stock may offer possibilities of tax postponement.)
  6. Desire for a continuing equity interest in buyer's corporation. Negotiate Agreement.
- A. Determine by whom costs of transactions are to be paid.
1. Broker's commissions.
  2. Legal fees.
  3. Accounting fees.
  4. Asset appraisals.
  5. Liquidation costs.
  6. Stock transfer taxes.

B. Consider employee responsibilities.

1. Consider what severance or terminal pay obligations the seller may have after the transaction for employees not retained by the buyer.
2. Consider whether any employees of the seller, particularly those who are shareholders, will be retained by the buyer under long-term contracts or other arrangements.
3. Determine whether shareholder-employees of the seller, who are not retained, will be required by the buyer to enter into agreements not to compete.
4. Determine whether buyer will assume responsibilities under existing pension and profit-sharing plans.

C. Maintain secrecy during negotiations.

1. Consider the possible dangers of premature disclosure of negotiations and of a pending transaction to relationships with suppliers, competitors, employees, credit sources, and the current market price of stock.
2. Avoid, if possible, creating the impression that the business is “on the block.”

D. Obtain necessary commitments from buyer.

1. Representation that the buyer has the legal capacity to enter the transaction.
2. If part of purchase price is to be deferred either in the form of fixed or contingent payments, any restrictions or agreements necessary to protect the seller from action by the buyer after the sale that might adversely affect the seller’s ability to collect such payments.
3. If liabilities of the seller are being assumed, any warranties and/or escrow provisions necessary to ensure that the buyer has effectively assumed and will pay when due all liabilities of which the seller desires to be relieved, including liabilities that may not be stated on the balance sheet.
4. If stock of the seller is being acquired by the buyer, that any such stock will be held for investment rather than for sale if necessary to avoid problems under federal or state securities laws.

**This BMA was reviewed by Allen Berger, CPA of Blackman Kallick Bartelstein, LLP, Chicago, Illinois**